Federal Home Loan Bank of Seattle

Third Quarter 2004 / Financial Report

Federal Home Loan Bank Seattle

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To Our Members

Experience teaches us that, when times are tough, it's best to face up to the challenges. The same holds true today, as we announce our third-quarter earnings.

The Seattle Bank continues to be a profitable and well-capitalized, safe and sound institution.

But, as our financial report indicates this quarter, the performance of our bank has been trending downward. Third quarter profitability, at $16.8 million, represented a disappointing 53 percent decline from the same quarter last year.

Our quarterly earnings declined due primarily to two factors. First, we did not adequately anticipate the prolonged period of low interest rates and their effect on our business. Low interest rates depressed our earnings on capital, and left us with a long-term debt overhang that could not be called or retired when our assets prepaid. We also did not efficiently manage the funding and hedging of our investments, mortgage-backed securities, and the Mortgage Purchase Program (MPP) amid this low interest-rate environment. The result was a reduction in our net interest income.

Second, our two core product lines, Advances and the MPP, did not perform as well as expected this quarter. Advances balances were below third-quarter 2003 levels by 28 percent, mostly because of reduced demand among our largest members and prevailing high liquidity levels in the marketplace. The MPP was affected by decreasing volumes throughout the mortgage banking industry, as well as our decision to limit purchases from large members as we worked on enhancing financial infrastructure. In addition, accelerated premium amortization negatively impacted the financial results of our mortgage business this quarter. Mortgage loans held for portfolio dipped by four percent, and MPP net income dropped significantly relative to the bank's third quarter of last year.

Faced with higher cost of funds and lower asset performance, we added to our investment portfolio to bolster earnings. At quarter end, investments were our largest asset class. Granted, we benefited from the additional income these investments created this quarter, but a more sizeable investment portfolio will likely add to the bank's interest rate risk profile down the road.

We share your concern over recent financial performance. Consequently, we believe it is critically important that we help you understand what to expect moving forward.

We anticipate that the future will bring, at least in the near term, tempered financial performance and increasing regulatory oversight. Interest-rate volatility is surely not a temporary phenomenon, and effectively dealing with it is, and will remain, a complex, yet critical task of the Seattle Bank. Following guidance from our regulator, the Federal Housing Finance Board (Finance Board), the Seattle Bank implemented a new retained earnings target that will likely lower dividend rates by at least 50 basis points annually for the next three years. The Finance Board is currently reviewing our revised policy and may require us to again increase our level of retained earnings, which would further impact future dividends.

Given the challenges facing the Seattle Bank, it's time to make some changes.

Financially, the bank will have to do some retooling. We are taking a hard look at the bank's assets and liabilities operations. We will work diligently to reprice our debt, improve spreads, and reduce our current level of interest rate risk exposure. During the third quarter, we accumulated higher levels of investment holdings relative to Advances and the MPP. We will begin to decrease our investment portfolio to focus more on our mission-related assets.

We're also looking to bring more balance back to our business. This calls for creating a product structure that not only emphasizes a robust mortgage program, but also a strong Advances business. Enhancing our Advances business may be one way to help offset some of the impact of both reduced mortgage volumes and interest-rate fluctuations.

Finally, I want to thank Kelli Bono for her many years of service to our cooperative. In October, Kelli announced she would step down as the bank's executive vice president and chief financial officer, effective December 1, 2004. Steve Horton—previously senior vice president and credit officer—is now handling the bank's CFO responsibilities on an interim basis and providing excellent leadership as we move quickly to improve the bank's financial performance.

Although we still have a difficult climb ahead of us, we are taking positive steps to secure and enhance the value of our cooperative for the future.

Thank you for your ongoing partnership.

Sincerely,

Norman B. Rice
President and
Chief Executive Officer

Federal Home Loan Bank of Seattle

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Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis reviews our financial condition as of September 30, 2004, our results of operations for the three and nine months ended September 30, 2004 and 2003, and where appropriate, factors that may affect our future financial performance. This discussion should be read in conjunction with our Management's Discussion and Analysis of Financial Condition and Results of Operations and annual audited financial statements as of December 31, 2003, contained in our 2003 Annual Report, and the unaudited financial statements and related condensed notes included in this report.

The amounts used to calculate percentage variances are based on numbers in thousands, and the amounts used to calculate average yields are based on whole numbers. Accordingly, recalculations of percentage variances and average yields may not produce the same results when the relevant amounts are disclosed only in thousands, millions, or billions.

Forward-Looking Information

This report contains certain forward-looking statements that are subject to risk and uncertainty. These statements describe our expectations regarding future events and developments, including future operating results, growth in assets, and continued success of our products. These statements include, without limitation, statements as to future expectations, beliefs, plans, strategies, objectives, events, conditions, and financial performance. The words "will," "believe," "expect," "intend," "may," "could," "should," "anticipate," and words of similar nature are intended in part to help identify forward-looking statements.

Future events are difficult to predict, and the expectations described in this report, including any forward-looking statements, are subject to risk and uncertainty that may cause actual results to differ materially from those we currently anticipate. Consequently, there is no assurance that the expected results will be achieved. Factors that may cause actual results to differ materially from those discussed in this report include, among others, the following:

- Changes in interest rates could reduce interest-rate spreads more than expected and could negatively affect other aspects of our business.
- Volatility of market prices, interest rates, and interest-rate indices could affect the value of our investments and derivatives, as well as the value of collateral that we hold as security.
- A sustained low interest-rate environment could continue to result in faster-than-expected prepayments and lower-than-expected yields on mortgage assets.
- Changes in our membership, such as the withdrawal of one or more large members, could affect our capital levels and our ability to generate income.
- Regulatory or legislative changes could cause us to modify our current structure, policies, or business operations in ways that could adversely impact both our results of operations and our ability to pay dividends to our members.
- Competitive pressure among financial institutions in the secondary mortgage market could increase, thereby reducing the margins on the loans we purchase under our Mortgage Purchase Program (MPP).
- Competitive pressure among other Federal Home Loan Banks (FHLBanks) could continue to reduce the demand for our advances or the interest rates we receive on our advances.

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- Business volumes for advances and our mortgage loans purchased under the MPP could be lower than expected.
- Changes in investor demand for consolidated obligations or changes in our ability to participate in consolidated obligations could affect our borrowing costs and access to funds.
- Costs or regulatory requirements could constrain our ability to introduce new products, and delays in the introduction of, or acceptance of, such products could adversely affect our revenues.
- We may not be able to fully offset gains and losses on our securities held at fair value with gains and losses on our associated derivatives.
- Negative adjustments in our credit agency ratings could adversely impact the marketability of our consolidated obligations, products, or services.
- Changes in accounting rules, or in the interpretation of existing rules, could contribute to volatility in our earnings.
- Restrictions on our ability to invest in the consolidated obligations of other FHLBanks could adversely affect our investment income.
- Political events, including legislative, regulatory or judicial that affect the FHLBanks or their members could contribute to volatility in earnings.
- If another FHLBank were unable to make principal or interest payments, we could be required to make payments on behalf of the defaulting FHLBank on their consolidated obligations.
- Local and national economic conditions could be less favorable than expected or could have a more direct and pronounced effect on our business than expected. Changes in these conditions could adversely affect our ability to grow and maintain the quality of our earning assets.
- Events such as terrorism, natural disasters, or other catastrophic events could disrupt the financial markets where we obtain funding, our borrowers' ability to repay advances, or the value of the collateral that we hold.

These cautionary statements apply to all related forward-looking statements, wherever they appear in this report. We do not undertake to update any forward-looking statements that we make in this report or that we may make from time to time.

Operating results for the three and nine months ended September 30, 2004, are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

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Overview

About the Federal Home Loan Bank System

The Federal Home Loan Bank of Seattle (Seattle Bank), a federally chartered corporation, is one of 12 district FHLBanks that, along with the Federal Housing Finance Board (Finance Board) and the Office of Finance, comprise the Federal Home Loan Bank System (Bank System). The FHLBanks serve the public by enhancing the availability of credit for residential mortgages and targeted community development.

The Finance Board, an independent agency in the executive branch of the United States (U.S.) government, supervises and regulates the FHLBanks and the Office of Finance, which is the FHLBanks' agent for debt issuance. The Finance Board is charged with ensuring that the FHLBanks operate in a safe and sound manner, carry out their housing finance mission, remain adequately capitalized, and can raise funds in the financial markets. In addition, the Finance Board establishes policies and regulations covering the operations of the FHLBanks. Each FHLBank operates as a separate entity with its own management, employees, and board of directors.

The FHLBanks' debt instruments (consolidated obligations) are the joint and several obligations of all the FHLBanks and the primary source of funds for the FHLBanks. Deposits, other borrowings, short-term investments, and capital stock issued to members provide additional funds. These funds are primarily used to provide advances to members and to purchase mortgage loans.

About the Seattle Bank

The Seattle Bank is a cooperative in which member institutions own the capital stock of the bank and may receive dividends on their investments. Regulated financial depositories and insurance companies engaged in residential housing finance may apply for membership. All members must purchase stock in the Seattle Bank in amounts determined in accordance with the Seattle Bank's capital plan.

To serve the needs of our members, our business model includes two operating segments, traditional member finance and MPP. We created the MPP in 2001 in an effort to diversify our product offerings and generate additional revenue and value for our cooperative. We believe that a healthy, safe, and sound mortgage program, together with our traditional member finance line of business, will best service the needs of our members in both the short- and long-term.

The traditional member finance segment includes advances, investments, and the borrowing costs related to these assets, as well as financial advisory and other fee-based member services. The MPP segment includes mortgage loans that are purchased for our portfolio from participating member institutions and the related financing costs and services associated with this program. Our major source of financing is the consolidated obligations issued through the Office of Finance. Although the FHLBanks are jointly and severally liable on all consolidated obligations, individual banks are primarily liable for an allocated portion of the consolidated obligations in which they participate. All references in this report to our consolidated obligations are to our allocated portion of those consolidated obligations in which we participate. All references to the consolidated obligations of other FHLBanks are to their allocated portion of the consolidated obligation in which they participate.

Our major source of income is net interest income, which is defined as the income received on our interest-earning assets less the interest expense paid on our interest-bearing liabilities. Our financial results are significantly impacted by changes in interest rates and, to a lesser extent, by U.S. economic

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conditions resulting from the level of interest rates. We use a number of tools to manage our interest-rate risk, including derivatives.

The prolonged period of low interest rates beginning in 2002 has resulted in a trend to lower net income, as we invest capital at progressively lower rates. We expect our net income to remain at or slightly below existing levels until interest rates increase and stabilize and we are able to reposition our assets and liabilities. Our two lines of business, traditional member finance and MPP, have been negatively impacted by low interest rates, resulting in rapid rates of prepayment on mortgage-based assets, and lower returns on invested capital. We believe that interest rate volatility will persist. We have been working to build our operational infrastructure to better manage risks inherent in a more complex statement of condition. The Board of Directors is considering actions that may be necessary to improve our operating performance. These actions could include, among other things, further review and adjustment of our business plan, reconsideration of our dividend policy and practices, modifications of retained earnings policies, and enhancements to Board and management oversight.

Regulatory Issues and Developments

MortgageChoice New Business Application. During the third quarter of 2004, we submitted a new business application to the Finance Board for approval of a mortgage program enhancement called MortgageChoice. MortgageChoice is a program, if approved, that will enable the Seattle Bank to purchase mortgage securities from our member institutions and either hold them as investments in our asset portfolio or resell them to other FHLBanks and outside investors. MortgageChoice was developed to help foster additional growth in our mortgage business, enhance the bank's risk management capabilities, and offer our members an additional secondary mortgage market alternative. The new business application for MortgageChoice was recently submitted to the Finance Board and is pending review.

Retained Earnings Policy. In September 2004, the Seattle Bank's Board of Directors adopted a revised retained earnings policy and increased its target level of retained earnings following guidance from the Finance Board. Under this revised retained earnings policy, we increased the target level of retained earnings from $35.0 million to $89.0 million. The Finance Board is currently reviewing our revised policy and may require us to again increase our level of retained earnings, which would further impact future dividends.

Registration with Securities and Exchange Commission. On June 23, 2004, the Finance Board adopted its proposed regulation requiring each FHLBank to register a class of its equity securities with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, as amended (Exchange Act). The regulation requires the Seattle Bank to file a registration statement with the SEC by June 30, 2005, and to ensure that the registration statement is declared effective by August 29, 2005. Once our stock is registered, we will file quarterly, annual and other periodic reports with the SEC pursuant to the Exchange Act, and we will comply with other applicable SEC rules and regulations.

In October 2004, the Finance Board provided guidance to the FHLBanks, in which the FHFB strongly encouraged each of the FHLBanks to prepare an initial draft of its SEC registration statement by December 31, 2004, for informal review by the SEC. We intend to comply with this guidance.

Government-Sponsored Enterprise (GSE) Regulation. Congressional scrutiny of GSEs increased during the third quarter of 2004, primarily as a result of a September 2004 Office of Federal Housing Enterprise Oversight (OFHEO) report criticizing accounting procedures at the Federal National Mortgage Association (Fannie Mae). Although the FHLBanks were not the subject of the OFHEO report, Congressional and public reaction to the report may have increased the prospect of new legislation affecting not only Fannie Mae,

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but also other GSEs. Earlier this year, a bill that would create a new regulator for Fannie Mae, the Federal Home Loan Mortgage Corporation (Freddie Mac), and the FHLBanks passed the Senate Banking Committee; however, the bill has not come up for a vote in the full Senate. The bill would combine OFHEO and the Finance Board into a new regulatory agency. It is impossible to predict what, if any, provisions relating to the Finance Board and the FHLBanks may ultimately be included in this bill or any similar legislation. In addition, if the House and Senate were to approve some form of GSE legislation, it is not clear whether any change in regulatory structure would be signed into law, when any change would go into effect if enacted, or what effect the legislation would have on the Finance Board or the FHLBanks.

Recent Rating Agency Actions

Standard & Poor's (S&P) rating agency continues to maintain a negative outlook on the individual counterparty ratings of the FHLBanks of Seattle, Des Moines, and Indianapolis, and in July 2004, lowered the long-term debt rating for the FHLBank of Chicago from AAA, its highest rating, to AA+. In taking these actions, S&P cited concerns about the impact of growing mortgage-based asset portfolios on the banks' risk profiles. Mortgage-based assets carry a higher risk compared to the traditional assets held by the FHLBanks. In November 2003, S&P has reaffirmed both the Seattle Bank's and the Bank System's ratings, which are AAA for long-term consolidated obligations and A-1+ for short-term consolidated obligations.

We periodically provide the rating agencies with information, as requested, to address their questions regarding the MPP and our operations. In August and September of 2004, we met with S&P representatives and provided them with detailed information regarding the MPP and MortgageChoice, including the unique credit-risk-sharing features of these programs, as well as our financial condition and the practices we use to manage interest-rate risk.

In a credit opinion issued in October 2004, Moody's Investor Service, Inc. (Moody's) provided the Seattle Bank with an Aaa long-term deposit rating and declared our rating outlook to be stable.

There can be no assurance that S&P will change our counterparty rating outlook back to stable or that S&P, Moody's, or other rating agencies will not reduce our counterparty rating or their ratings of our consolidated obligations or those of the Bank System in the future.

A change in a rating outlook reflects a rating agency's assessment of the potential direction of a long-term credit rating over the immediate- or long-term. Individual FHLBank ratings do not necessarily impact the credit rating of the consolidated obligations issued on behalf of the FHLBanks. Rating agencies may, from time to time, change a counterparty rating because of various factors, including operating results or actions taken, business developments, or changes in their opinion regarding, among other things, the general outlook for a particular industry or the economy.

Summary of Critical Accounting Estimates

Our financial statements and reported results are prepared in accordance with U.S. generally accepted accounting principles (GAAP), which require the use of estimates and assumptions that may affect our reported results and disclosures. Several of these accounting policies involve the use of accounting estimates that we consider to be critical as: (i) they are likely to change from period to period because they require significant management judgment and assumptions about highly complex and uncertain matters, and (ii) the use of a different estimate or a change in estimate could have a material impact on our reported results of operations or financial condition. We review our estimates and assumptions frequently.

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Estimates and assumptions that are significant to our results of operations and financial condition include: (1) assets and liabilities reported at fair value, (2) accounting for derivatives, (3) allowance for credit losses, (4) amortization of premiums/accretion of discounts, (5) joint and several liability on the Bank System's consolidated obligations, and (6) liability for Resolution Funding Corporation (REFCORP). These critical accounting estimates are described in the Summary of Critical Accounting Estimates section of Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1 to the financial statements, "Summary of Significant Accounting Policies," of our 2003 Annual Report.

Results of Operations

Our operating results for the three and nine months ended September 30, 2004, continue to reflect the negative impact of low interest rates on our income. For the three and nine months ended September 30, 2004, net income was down 52.8% and 40.3% from the same periods in 2003.

Interest rates impacted net income in two ways during the third quarter. First, the bank has more short-term liabilities than assets, and the increase in short-term interest rates, driven by the 75 basis-point increase in the Federal funds rate during the second and third quarters, increased our short-term cost of funds more than it increased our asset yields. In addition, long-term interest rates have continued to fall, negatively impacting the yields on our MPP assets and long-term investment portfolio. Second, interest-rate fluctuations during the third quarter of 2004 and expectations of the timing and amount of future interest-rate increases resulted in an increase in prepayment speeds on mortgage loans, accelerating the premium amortization of our mortgage-based assets and negatively impacting interest income and average yields. A slowdown in prepayment speeds occurred in the third quarter of 2003, which resulted in more modest premium amortization during that quarter. We expect that premium amortization on our mortgage-based assets will continue to fluctuate as prepayment speed estimates and interest rates change.

Net Interest Income

Our net interest income consists of interest earned on advances, mortgage loans held for portfolio, and investments, less interest paid on consolidated obligations, deposits, and other borrowings. We use net interest income as the primary performance measure of our ongoing operations.

The following table presents our net interest income for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
(in thousands, except percentage data)						
Interest income	**$ 423,391**	$ 367,107	15.3	**$ 1,229,112**	$ 1,155,578	6.4
Interest expense	**386,753**	326,886	18.3	**1,108,797**	1,004,332	10.4
Net Interest Income	**$ 36,638**	$ 40,221	(8.9)	**$ 120,315**	$ 151,246	(20.5)

While both total interest income and total interest expense increased for the three and nine months ended September 30, 2004, compared to the prior period amounts, net interest income decreased as a result of both a reduction in volume of the bank's higher-earning assets and the bank owning more short-term

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liabilities than short-term assets in a rising short-term rate environment. This resulted in a net decrease in our net interest income for the three and nine months ended September 30, 2004 compared to the same periods in 2003.

Our advances outstanding decreased steadily during 2004, primarily reflecting the maturity and non-renewal of balances of two large member institutions. The volume of mortgage loans held for portfolio has not grown as much as we anticipated during 2004 and therefore did not offset the reduction in our advances balances. Furthermore, interest income on the mortgage loans held for portfolio has been negatively impacted by premium amortization due to changes in prepayment speeds. In addition, our higher-yielding mortgage loans held for portfolio that were prepaid during the period were generally replaced by new mortgage loans with lower average yields. As the maturing advances and mortgage loans were repaid, we were not able to reduce our outstanding consolidated obligations commensurately, due to lock-out periods on our retirement of the consolidated obligations. As a result, we used the proceeds from the repayment of advances and maturing mortgage loans held for portfolio to purchase investment securities, primarily other FHLBanks' consolidated obligation bonds. Although these bonds offer higher yields, compared to short-term investments, the higher yield did not increase our interest income sufficiently to offset the reduction in interest income attributable to the decrease in outstanding advances. We have discontinued the purchase of other FHLBank consolidated obligation bonds and are in the processing of reviewing our business strategies related to our investment portfolio. This decision may adversely impact the return we are able to earn on our investments in future periods.

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Average Balances, Interest Income and Expense, and Average Yields. The following table presents average balances and yields, and interest income and expense of major interest-earning asset and interest-bearing liability categories, for the three months ended September 30, 2004 and 2003. It also presents spreads between the average yield on total earning assets and the average cost of interest-bearing liabilities for these periods.

	September 30, 2004			September 30, 2003		
For the three months ended	Average Balance	Interest Income / Expense	Average Yield %	Average Balance	Interest Income / Expense	Average Yield %
(in thousands, except average yield data)						
Interest-Earning Assets						
Advances	$ 16,834,152	$ 106,592	2.52	$ 22,918,685	$ 130,186	2.25
Investments	22,400,879	186,629	3.31	14,599,701	126,414	3.44
Mortgage loans held for portfolio	10,959,592	130,161	4.72	8,553,960	110,506	5.13
Other interest-earning assets	2,431	9	1.34	414	1	0.92
Total interest-earning assets	50,197,054	$ 423,391	3.35	46,072,760	$ 367,107	3.16
Other assets	261,189			274,017		
Total assets	$ 50,458,243			$ 46,346,777		
Interest-Bearing Liabilities						
Consolidated obligations	$ 46,122,223	$ 383,175	3.31	$ 41,142,416	$ 322,497	3.12
Deposits	1,053,038	3,578	1.35	1,902,718	4,383	0.91
Other borrowings				2,228	6	1.16
Total interest-bearing liabilities	47,175,261	$ 386,753	3.26	43,047,362	$ 326,886	3.01
Other liabilities	809,952			798,174		
Capital	2,473,030			2,501,241		
Total liabilities and capital	$ 50,458,243			$ 46,346,777		
Net interest income		$ 36,638			$ 40,221	
Interest-rate spread			0.09			0.15

For the three months ended September 30, 2004, compared to the same period in 2003, the average yield on our interest-earning assets increased at a slower rate than the average yield on our interest-bearing liabilities, resulting in continued compression in our interest-rate spread, and a decrease in net interest income.

Long-term interest rates have continued to fall, negatively impacting the yields on our advances, MPP assets, and long-term investment portfolio. A decline in our deposit balance resulted in substituting our funding with consolidated obligations. Consolidated obligations carry a higher funding cost than deposits. The increase in the federal funds rate by 75 basis points in the second and third quarters of 2004 contributed to the increase in the cost of our consolidated obligations, which generally reprice more frequently than our longer-term assets. Although changes in interest rates generally impact both interest-earning assets and interest-bearing liabilities, the impact may not be simultaneous due to differences in the length of the repricing periods of those assets and liabilities.

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The following table presents average balances and yields, and interest income and expense of major interest-earning asset and interest-bearing liability categories, for the nine months ended September 30, 2004 and 2003. It also presents spreads between the average yield on total earning assets and the average cost of interest-bearing liabilities for these periods.

	September 30, 2004			September 30, 2003		
For the nine months ended	Average Balance	Interest Income / Expense	Average Yield %	Average Balance	Interest Income / Expense	Average Yield %
(in thousands, except average yield data)						
Interest-Earning Assets						
Advances	$ 17,928,550	$ 314,151	2.34	$ 21,978,726	$ 399,825	2.43
Investments	20,576,394	501,550	3.26	15,434,259	434,094	3.76
Mortgage loans held for portfolio	11,247,000	413,402	4.91	8,494,241	321,619	5.06
Other interest-earning assets	870	9	1.31	4,182	40	1.28
Total interest-earning assets	49,752,814	$ 1,229,112	3.30	45,911,408	$ 1,155,578	3.37
Other assets	268,934			301,258		
Total assets	$ 50,021,748			$ 46,212,666		
Interest-Bearing Liabilities						
Consolidated obligations	$ 45,651,032	$ 1,100,182	3.22	$ 41,129,915	$ 989,721	3.22
Deposits	1,097,382	8,612	1.05	1,821,590	14,506	1.06
Other borrowings	296	3	1.19	9,634	105	1.46
Total interest-bearing liabilities	46,748,710	$ 1,108,797	3.17	42,961,139	$ 1,004,332	3.13
Other liabilities	799,405			801,499		
Capital	2,473,633			2,450,028		
Total liabilities and capital	$ 50,021,748			$ 46,212,666		
Net interest income		$ 120,315			$ 151,246	
Interest-rate spread			0.13			0.24

For the nine months ended September 30, 2004, compared to the same period in 2003, the average yield on our interest-earning assets decreased while the average yield on our interest-bearing liabilities increased, compressing our interest-rate spread, and decreasing our net interest income. The compression of our interest-rate spread is due to the differences in the timing of changing interest rates on our interest-earning assets and interest-bearing liabilities. The impact may not be simultaneous due to the differences in the length of the repricing periods of these assets and liabilities.

Changes in the composition of our interest-earning assets and interest-bearing liabilities affect our interest-rate spread and net interest income. A decline in our lower-cost deposit balance resulted in an increase in our use of higher-cost consolidated obligations. In addition, increases and decreases in the rate of growth and in the average yield of our interest-earning assets and interest-bearing liabilities cause fluctuations in our net interest income. Changes in the rate of growth and average yield may be driven by economic factors or by changes in our products or services. These changes are summarized in the Changes in Volume and Rate section below.

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Changes in Volume and Rate. Our net interest income is impacted by changes in the dollar volume (volume) of our interest-earning assets and interest-bearing liabilities and changes in the average yield (rate) for both the interest-earning assets and interest-bearing liabilities. For example, interest income on advances declined by $23.6 million, to $106.6 million, for the three months ended September 30, 2004, compared to $130.2 million for the same period in 2003. As the table below illustrates, the decrease of $23.6 million was due to a $37.3 million decline in interest income attributable to a decline in volume, offset by a $13.7 million increase in interest income attributable to an increase in average yield.

The following tables summarize increases and decreases in interest income, interest expense, and net interest income due to changes in the volume of interest-earning assets and interest-bearing liabilities and changes in the average rate for the three and nine months ended September 30, 2004 and 2003, compared to the prior period.

	2004 vs. 2003 Increase (Decrease)			2003 vs. 2002 Increase (Decrease)		
For the three months ended September 30,	Volume*	Rate*	Total	Volume*	Rate*	Total
(in millions)						
Interest Income						
Advances	$ (37.3)	$ 13.7	$ (23.6)	$ (41.7)	$ 10.1	$ (31.6)
Investments	65.2	(4.9)	60.3	(38.5)	(40.8)	(79.3)
Mortgage loans held for portfolio	29.1	(9.5)	19.6	(11.3)	59.5	48.2
Total interest income	57.0	(0.7)	56.3	(91.5)	28.8	(62.7)
Interest Expense						
Consolidated obligations	40.6	20.1	60.7	(47.1)	13.1	(34.0)
Deposits and other borrowings	(2.4)	1.6	(0.8)	(3.6)	0.3	(3.3)
Total interest expense	38.2	21.7	59.9	(50.7)	13.4	(37.3)
Change in net interest income	$ 18.8	$ (22.4)	$ (3.6)	$ (40.8)	$ 15.4	$ (25.4)

**Changes in interest income and interest expense not identifiable as either volume-related or rate-related, but rather equally attributable to both volume and rate changes, are allocated to volume and rate categories based on their relative size.*

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For the nine months ended September 30,	2004 vs. 2003 Increase (Decrease)			2003 vs. 2002 Increase (Decrease)		
	Volume*	Rate*	Total	Volume*	Rate*	Total
(in millions)						
Interest Income						
Advances	$ (71.5)	$ (14.2)	$ (85.7)	$ (98.1)	$ (2.8)	$ (100.9)
Investments	130.9	(63.4)	67.5	(97.6)	(85.4)	(183.0)
Mortgage loans held for portfolio	101.4	(9.7)	91.7	(27.7)	226.6	198.9
Total interest income	160.8	(87.3)	73.5	(223.4)	138.4	(85.0)
Interest Expense						
Consolidated obligations	109.0	1.5	110.5	(123.8)	75.6	(48.2)
Deposits and other borrowings	(5.8)	(0.2)	(6.0)	(8.2)	(0.9)	(9.1)
Total interest expense	103.2	1.3	104.5	(132.0)	74.7	(57.3)
Change in net interest income	$ 57.6	$ (88.6)	$ (31.0)	$ (91.4)	$ 63.7	$ (27.7)

**Changes in interest income and interest expense not identifiable as either volume-related or rate-related, but rather equally attributable to both volume and rate changes, are allocated to volume and rate categories based on their relative size.*

Interest Income

The following table presents the components of our interest income for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
(in thousands, except percentage data)						
Interest Income						
Advances	$ 106,592	$ 130,186	(18.1)	$ 314,151	$ 399,825	(21.4)
Investments	186,638	126,415	47.6	501,559	434,134	15.5
Mortgage loans held for portfolio	130,161	110,506	17.8	413,402	321,619	28.5
Total	$ 423,391	$ 367,107	15.3	$ 1,229,112	$ 1,155,578	6.4

The increase in total interest income for the three and nine months ended September 30, 2004, compared to the same periods in 2003, is primarily due to the increase in the volume of our investments and mortgage loans held for portfolio, partially offset by a decrease in the volume of our advances outstanding. The shift in the composition of our interest income reflects the decline in demand for our advances, and the reinvestment of proceeds from the repayment of advances in mortgage loans and investments, primarily other FHLBanks' consolidated obligations.

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Advances. The decrease in interest income from advances for the three and nine months ended September 30, 2004, compared to the same periods in 2003, was primarily due to the decline in advances volume, which was the result of the maturity and non-renewal of advances by two large member institutions. Our advances outstanding decreased by $3.8 billion, to $15.8 billion, as of September 30, 2004, compared to December 31, 2003. A shift from long-term to short-term advances for the three and nine months ended September 30, 2004, compared to the same periods in 2003, contributed to the decline in interest income from advances.

Given the current low interest-rate environment and our members' access to liquidity from customer deposits, we expect continued declines in advances and interest income from advances in the near term. Our overall advances balance is dependent upon the borrowing decisions of a few large member institutions. If member institutions decide not to replace their maturing advances with new advances, we generally expect to reduce our consolidated obligations, subject to any restrictions on prepayment, and redeem our outstanding capital stock related to the matured advances.

The average yield on advances increased by 27 basis points, to 2.52%, for the three months ended September 30, 2004, from 2.25% for the same period in 2003, reflecting the increase in short-term interest rates during the second and third quarters of 2004. For the nine months ended September 30, 2004, the average yield on advances decreased by 9 basis points, to 2.34%, from 2.43% for the same period in 2003. The decline in average yields reflects a decrease in the advances portfolio primarily due to the maturity of advances issued during a higher interest-rate environment.

Investments. Interest income from investments, which includes short-term investments (e.g., interest-bearing deposits, securities purchased under agreements to resell, and federal funds sold), and long-term investments (e.g., held-to-maturity securities and securities held at fair value), increased by 47.6% and 15.5% for the three and nine months ended September 30, 2004, compared to the same periods in 2003, driven primarily by a significant increase in the size of our investment portfolio.

Although our interest income on investments increased in 2004, compared to 2003, because of increased volumes, the average yield decreased by 13 basis points and 50 basis points for the three and nine months ended September 30, 2004, compared to the same periods in 2003. The decrease in our average yield was due to a significant dollar amount of prepayments on mortgage-backed securities that we held and sales of held-to-maturity mortgage-backed securities that paid down to less than 15% of the original principal balance during 2003, and our subsequent reinvestment of the proceeds at lower prevailing rates.

Mortgage Loans Held for Portfolio. Interest income from mortgage loans held for portfolio increased by 17.8% and 28.5% for the three and nine months ended September 30, 2004, compared to the same periods in 2003, due primarily to an increase in the volume of mortgage loans purchased under the MPP. Although interest income increased, the growth in volume was partially offset by a decrease in the average yield of 15 basis points, to 4.91%, for the nine months ended September 30, 2004, compared to 5.06% for the same period in 2003, due to the increase in the amount of premium amortization driven by changing mortgage loan prepayment speeds.

For the three months ended September 30, 2004, mortgage loan prepayment speeds continued to cause volatility in our interest income by increasing the rate of premium amortization, which reduced our interest income and average yields. The premium amortization on mortgage loans held for portfolio totaled $13.0 million for the three months ended September 30, 2004, compared to $4.3 million for the same period in 2003. Our average yield from mortgage loans held for portfolio decreased by 41 basis points, to 4.72%, for the three months ended September 30, 2004, compared to 5.13% for the same period in 2003.

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For the nine months ended September 30, 2004 and 2003, premium amortization on mortgage loans held for portfolio totaled $28.2 million and $31.6 million.

Because most of our mortgage loans held for portfolio were acquired at a premium above the principal value, increases in prepayment speeds negatively impact our earnings as more premium is amortized into earnings during the current period. Premium is amortized into earnings over the expected life of the mortgage loan as an adjustment to interest income and average yield, and any changes to the expected life of the mortgage loan impact the amortization amount and period. If prepayment speeds on a mortgage loan increase, we recognize additional premium amortization in the current period to reflect the shorter expected life of the mortgage loan, reducing both the interest income and the average yield on the loan for the period. If prepayment speeds decrease, we recognize less premium amortization in the current period to reflect the longer expected life of the mortgage loan, which can have the effect of increasing interest income and average yields for the period. During periods of low or decreasing interest rates, prepayment speeds often increase as homeowners prepay their mortgage loans and replace their higher rate mortgage loans with mortgage loans at lower interest rates, and during periods of high or increasing interest rates, prepayment speeds often decrease as homeowners maintain their existing mortgage loans.

Interest Expense

The following table presents the components of our interest expense for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
(in thousands, except percentage data)						
Interest Expense						
Consolidated obligations	**$ 383,175**	$ 322,497	18.8	**$ 1,100,182**	$ 989,721	11.2
Deposits	**3,578**	4,383	(18.4)	**8,612**	14,506	(40.6)
Other borrowings		6	(100.0)	**3**	105	(97.1)
Total	**$ 386,753**	$ 326,886	18.3	**$ 1,108,797**	$ 1,004,332	10.4

Consolidated Obligations. Interest expense on consolidated obligations increased for the three and nine months ended September 30, 2004, compared to the same period in 2003, primarily due to the increase in the balance of our consolidated obligations outstanding. The average yield on our consolidated obligations increased by 19 basis points, to 3.31%, for the three months ended September 30, 2004, compared to the same period in 2003. However, for the nine months ended September 30, 2004 and 2003, the average yield remained the same at 3.22%.

Deposits. Interest expense on deposits for the three and nine months ended September 30, 2004 and 2003, continued to decrease because of lower deposit balances.

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Other Income (Loss)

Other income (loss) includes member service fees, advance prepayment fees, gain and loss on derivatives and hedging activities, and other miscellaneous income or loss not included in net interest income. Because of the type of financial activity reported in this category, other income (loss) can be volatile from one period to another. For instance, advance prepayment activity and associated fees may vary based on individual member liquidity and balance sheet restructuring activity, mergers and acquisitions among member institutions, and other factors. Gain and loss on derivatives and hedging activities is highly dependent on changes in interest rates and spreads between various interest-rate yield curves.

The following table presents the components of our other income and loss for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
(in thousands, except percentage data)						
Other Income (Loss)						
Prepayment fees	**$ 408**	$ 8,364	(95.1)	**$ 660**	$ 9,783	(93.3)
Service fees	**559**	644	(13.2)	**1,717**	1,780	(3.5)
Net realized gain on sale of held-to-maturity securities	**1,195**	9,423	(87.3)	**2,818**	19,660	(85.7)
Net unrealized gain (loss) on securities held at fair value	**14,375**	(12,781)	212.5	**6,687**	(1,250)	635.0
Net realized and unrealized gain (loss) on derivatives and hedging activities	**(19,989)**	10,701	(286.8)	**(10,524)**	(8,913)	(18.1)
Other, net	**(252)**	61	(513.1)	**(201)**	442	(145.5)
Total	**$ (3,704)**	$ 16,412	(122.6)	**$ 1,157**	$ 21,502	(94.6)

Prepayment Fees. Finance Board regulations generally require advances with a maturity or repricing period greater than six months to carry a prepayment fee sufficient to make us financially indifferent to the borrower's decision to prepay the advances. The amount of prepayment fees depends upon the prepaid advance's time to maturity and interest rate. Primarily as a result of the merger of two members during mid-2003, we recorded prepayment fees of $8.4 million and $9.8 million for the three and nine months ended September 30, 2003.

Net Realized Gain on Sale of Held-to-Maturity Securities. Net realized gain on the sale of held-to-maturity securities decreased for the three and nine months ended September 30, 2004, compared to the same periods in 2003. These sales are the result of our ongoing review of our investment portfolio to identify small dollar securities for which the cost to maintain the investments exceeds their value to the Seattle Bank (e.g., investments paid down to less than 15% of their original balance). Sales of such securities are made in accordance with GAAP.

In 2003, we sold a number of held-to-maturity securities that were paid down to less than 15% of their original balances. In 2004, the number of held-to-maturity securities we sold decreased because paydowns slowed and fewer investments in the portfolio met the accounting criteria for sale.

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Net Realized and Unrealized Gain and Loss on Derivatives and Hedging Activities and Net Unrealized Gain and Loss on Securities Held at Fair Value. Our net realized and unrealized gain and loss on derivatives and hedging activities and net unrealized gain and loss on securities held at fair value comprise the majority of our other income (loss).

The following table summarizes the components of net realized and unrealized gain and loss on derivatives and hedging activities, as well as net unrealized gain on securities held at fair value, for the three and nine months ended September 30, 2004 and 2003.

For the Three Months Ended	Advances	Securities Held at Fair Value	Mortgage Loan Commitments	Consolidated Obligation Bonds	Statement of Condition	Intermediary Positions	Total
(in thousands)							
September 30, 2004							
Net realized and unrealized gain (loss) on derivatives and hedging activities	$ (2)	$ (17,461)	$ 214	$ (1,605)	$ (1,119)	$ (16)	$ (19,989)
Net unrealized gain (loss) on securities held at fair value		14,375					14,375
Total	$ (2)	$ (3,086)	$ 214	$ (1,605)	$ (1,119)	$ (16)	$ (5,614)
September 30, 2003							
Net realized and unrealized gain (loss) on derivatives and hedging activities	$ 4	$ 13,391	$ (3,560)	$ 102	$ 803	$ (38)	$ 10,702
Net unrealized gain (loss) on securities held at fair value		(12,781)					(12,781)
Total	$ 4	$ 610	$ (3,560)	$ 102	$ 803	$ (38)	$ (2,079)

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For the Nine Months Ended	Advances	Securities Held at Fair Value	Mortgage Loan Commitments	Consolidated Obligation Bonds	Statement of Condition	Intermediary Positions	Total
(in thousands)							
September 30, 2004							
Net realized and unrealized gain (loss) on derivatives and hedging activities	$ 8	$ (13,081)	$ 953	$ (231)	$ (4,060)	$ (67)	$ (16,478)
Accounting adjustment:							
Unrealized gain from inception to March 31, 2004				2,941			2,941
Reclassification of deferred interest-rate swap fees				3,013			3,013
Net unrealized gain (loss) on securities held at fair value		6,687					6,687
Total	$ 8	$ (6,394)	$ 953	$ 5,723	$ (4,060)	$ (67)	$ (3,837)
September 30, 2003							
Net realized and unrealized gain (loss) on derivatives and hedging activities	$ 1	$ (4,849)	$ (3,753)	$ 221	$ (244)	$ (289)	$ (8,913)
Net unrealized gain (loss) on securities held at fair value		(1,250)					(1,250)
Total	$ 1	$ (6,099)	$ (3,753)	$ 221	$ (244)	$ (289)	$ (10,163)

Securities Held at Fair Value. Our securities held at fair value consist of one U.S. agency obligation. This obligation is economically hedged by an interest-rate exchange agreement. We record the changes in fair value of the securities held at fair value and the interest-rate exchange agreement as a net realized and unrealized gain and loss on derivatives and hedging activities on the statement of condition. Because of the volatility of U.S. agency obligation interest-rate spreads relative to the London Interbank Offered Rate (LIBOR) curve, the changes in the fair value of securities held at fair value have not been completely offset by the changes in fair value of the interest-rate exchange agreement. This volatility has resulted in large fluctuations in gains and losses for the three and nine months ended September 30, 2004, compared to the same periods in 2003, as presented in the table below.

We determine the change in fair value on securities held at fair value using quoted market prices from securities brokers. We calculate the change in fair value on the interest-rate exchange agreement based on estimated fair values of interest-rate exchange agreements on instruments with similar terms or available market prices. Although we expect the majority of the changes in fair value of securities held at fair value to be offset by opposite changes in fair value of the corresponding interest-rate exchange agreement, there will be differences that are reported in total other income (loss) on the statement of income. The shift of the realized and unrealized gain and loss amounts was due to the widening spread between swaps tied to LIBOR and U.S. agency obligations during the third quarter of 2004, which impacted our unrealized gain and loss on securities held at fair value and the corresponding interest-rate swap agreement.

The following table presents the components of unrealized gain and loss on the securities held at fair value compared to the unrealized gain and loss on the interest-rate exchange agreement that economically

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hedges that investment, net of the interest expense component, for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
(in thousands)				
Net realized and unrealized gain (loss) on derivatives and hedging activities on interest-rate exchange agreement	**$ (17,461)**	$ 13,391	**$ (13,081)**	$ (4,849)
Less: interest expense	**(2,752)**	(2,891)	**(8,591)**	(8,562)
Unrealized gain (loss)	**$ (14,709)**	$ 16,282	**$ (4,490)**	$ 3,713
Unrealized gain (loss) on securities held at fair value	**$ 14,375**	$ (12,781)	**$ 6,687**	$ (1,250)
Net difference between unrealized gain (loss) on securities held at fair value and Interest-rate exchange agreement	**$ (334)**	$ 3,501	**$ 2,197**	$ 2,463

Mortgage Loan Commitments. Effective July 1, 2003, commitments to purchase mortgage loans are classified as derivatives, and the changes in the fair value of the commitments are included in other income (loss). Prior to July 1, 2003, mortgage loan commitments were not classified as derivatives and were eligible for fair value hedge accounting treatment. As a result, only the ineffective portion between the mortgage loan commitment and the hedging instrument was recorded in current-period earnings. The difference in accounting treatment resulted in a gain for the three and nine months ended September 30, 2004, compared to losses in the same periods in 2003.

Consolidated Obligation Bonds. During the second quarter of 2004, we changed the manner of accounting used to value and measure ineffectiveness for certain highly-effective hedging relationships since our adoption of SFAS No. 133 on January 1, 2001. Under the prior approach, we assumed no ineffectiveness in these hedging transactions, while under the new approach we measure ineffectiveness at least quarterly. If this manner of accounting had been applied at the adoption of SFAS No. 133, the difference would not have been material to our results of operations or financial condition for any of these prior reporting periods since January 1, 2001. For the nine months ended September 30, 2004, we recorded an increase of $2.9 million to net income before assessments, reflecting the accounting as if we had employed the new approach since the date of adoption of SFAS No. 133 through March 31, 2004. In addition, as part of the accounting adjustment, we reclassified $3.0 million of deferred interest-rate swap agreement fees from interest expense to net realized and unrealized gain on derivatives and hedging activities. The reclassification relates to fees recognized on terminated interest-rate swap agreements hedging consolidated obligations that have been repaid. We expect that the methodology of measuring ineffectiveness on an ongoing basis will lead to more volatility in our net income in future periods. However, the cumulative amount of these changes should generally offset each other if the derivative and hedged item are both held to maturity or terminated on their respective call dates, which is generally the case for these transactions.

Statement of Condition. We hold $700 million notional (face) amount of interest-rate caps that are used to economically hedge changes in the fair value of our assets and liabilities. Because the interest-rate caps do not qualify for hedge accounting treatment, the changes in the fair value of the interest-rate caps are recorded as a net realized and unrealized gain (loss) on derivatives and hedging activities in the statement

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of income. The gains and losses are primarily caused by changes in the interest rates that impact the fair value of the interest-rate caps.

Other Expense

Other expense includes operating expenses, Finance Board and Office of Finance assessments, and other items, which consist primarily of mortgage loan administrative fees paid to vendors related to our mortgage loans held for portfolio.

The following table presents the components of our other expense for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
(in thousands, except percentage data)						
Other Expense						
Operating	**$ 8,751**	$ 7,120	22.9	**$ 28,608**	$ 20,205	41.6
Finance Board	**502**	490	2.4	**1,363**	1,469	(7.2)
Office of Finance	**232**	208	11.5	**854**	804	6.2
Other	**625**	438	42.7	**1,894**	1,524	24.3
Total	**$ 10,110**	$ 8,256	22.5	**$ 32,719**	$ 24,002	36.3

Operating Expenses. Operating expenses increased for the three and nine months ended September 30, 2004, compared to the same periods in 2003, primarily reflecting additions to staff to support the infrastructure required for our two operating segments and compliance with increased regulatory requirements. The personnel increases are intended to increase the level of expertise available to meet the needs of our changing business profile, regulatory environment, and financial management. Other infrastructure expenses include professional services to strengthen the financial and operational systems that support our business.

The following table presents the components of our operating expenses.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
(in thousands, except percentage data)						
Operating Expenses						
Salary and benefits	**$ 5,011**	$ 4,586	9.3	**$ 17,418**	$ 12,812	36.0
Cost of quarters	**1,145**	659	73.7	**2,980**	1,849	61.2
Other	**2,595**	1,875	38.4	**8,210**	5,544	48.1
Total	**$ 8,751**	$ 7,120	22.9	**$ 28,608**	$ 20,205	41.6

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Salary and benefits increased by $4.6 million for the nine months ended September 30, 2004, compared to the same period in 2003. This increase includes $550,000 related to salary and benefits increases for our 143 personnel employed as of September 30, 2003, and $4.1 million related to our 47 employees hired since September 30, 2003. As of September 30, 2004, our employee count totaled 190. The increase in staffing reflects our increased emphasis on building our infrastructure to meet the needs of our MPP and to comply with expanded regulatory requirements, including SEC registration.

Cost of quarters increased by $1.1 million for the nine months ended September 30, 2004, compared to the same period in 2003. The increase reflects new office space leased to accomodate the increase in personnel and an increase in existing lease expense in accordance with contract terms.

Other expenses increased by $2.7 million for the nine months ended September 30, 2004, compared to the same period in 2003. The increase is due primarily to the increase in professional fees and other contractual services of $1.5 million. Professional services includes services received in connection with building the infrastructure for MPP, employee search fees, consulting work in connection with SEC registration, compliance with Sarbanes-Oxley, and regulatory compliance.

Finance Board and Office of Finance. The Finance Board and Office of Finance expenses represent costs allocated to us by the Finance Board and Office of Finance. The amounts have remained stable for the three and nine months ended September 30, 2004 and 2003.

Assessments

The following table presents the components of our assessments for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
(in thousands, except percentage data)	2004	2003	% Increase (Decrease)	2004	2003	% Increase (Decrease)
Assessments						
Affordable Housing Program	**$ 1,863**	$ 3,949	(52.8)	**$ 7,245**	$ 12,143	(40.3)
REFCORP	**4,192**	8,886	(52.8)	**16,302**	27,321	(40.3)
Total	**$ 6,055**	$ 12,835	(52.8)	**$ 23,547**	$ 39,464	(40.3)

Assessments include funding for Affordable Housing Program (AHP) and REFCORP payments. The Federal Home Loan Bank Act of 1932, as amended (FHLB Act) requires each FHLBank to establish and fund an AHP to provide resources to member institutions for housing development to assist in the purchase, construction, and rehabilitation of homes for qualified households. Each FHLBank is required to set aside 10% of earnings before charges for assessments, but after the assessment for REFCORP. Because these assessments are calculated as a percentage of income before assessment, the AHP and REFCORP assessment amounts will fluctuate according to changes in our income.

Also, each FHLBank is required to make payments to REFCORP to support the payment of interest on the bonds issued by REFCORP for costs associated with the savings and loan insolvencies during the 1980s, until all bonds issued are repaid. Each FHLBank is required to pay 20% of net earnings after AHP to REFCORP.

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The AHP and RECORP assessments are calculated simultaneously, and the results from each assessment calculation are needed for the calculation of the other. The calculation of these assessments translates into an effective assessment rate of approximately 8.16% for AHP, and approximately 18.37% for REFCORP, of income before assessments.

Segment Results

We manage our operations by grouping our products into two operating segments: traditional member finance and the MPP. The traditional member finance segment includes revenues from advances, other member services, and income from investment securities, offset by the related funding costs. The MPP segment includes revenues from mortgage loans purchased from members, offset by the related funding costs, as well as other assets, income, and expenses directly related to the MPP. We allocate the AHP and REFCORP assessments to each segment, based on that segment's income as a percentage of total income before assessments.

During the third quarter of 2004, we reevaluated our method of allocating other expenses between the traditional member finance and MPP segments to better reflect the costs associated with each operating segment. The current and prior year amounts have been reclassified to conform to the new method of allocation.

Traditional Member Finance

The following table presents the components of our traditional member finance segment results for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
(in thousands)				
Traditional Member Finance				
Net interest income	**$ 30,659**	$ 22,432	**$ 80,980**	$ 109,443
Other income (loss)	**(3,979)**	19,948	**116**	25,181
Other expense	**(6,065)**	(6,156)	**(20,044)**	(17,250)
Income before assessments	**20,615**	36,224	**61,052**	117,374
Assessments	**(5,469)**	(9,610)	**(16,198)**	(31,140)
Net income	**$ 15,146**	$ 26,614	**$ 44,854**	$ 86,234

Net Interest Income. Our net interest income for the traditional member finance segment increased for the three months ended September 30, 2004, compared to the same period in 2003, due to favorable discount amortization adjustments on our mortgage-backed securities. The discount amortization was a favorable adjustment of $6.2 million for the three months ended September 30, 2004, compared to a unfavorable adjustment of $1.6 million for the same period in 2003. An increase in the interest-rate spread of 9 basis points, to 14 basis points, for the three months ended September 30, 2004, compared to the same period in 2003, also contributed to the increase in net interest income for this segment.

Our net interest income decreased for the nine months ended September 30, 2004, compared to the same period in 2003, due to a compression of our interest-rate spread, which decreased by 9 basis points,

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to 11 basis points, compared to the same period in 2003. See Results of Operations – Interest Income, above, for additional discussion about interest income on advances and investments.

Other Income (Loss). Total other income decreased for the three and nine months ended September 30, 2004, compared to the same period in 2003, due primarily to decreases in net unrealized and realized loss on derivatives and hedging activities and net unrealized loss on securities held at fair value.

During the second quarter of 2004, we changed the manner of accounting we used to value and measure ineffectiveness for certain highly-effective hedging relationship transactions since our adoption of SFAS No. 133 on January 1, 2001. See Other Income (Loss) – Unrealized Gain and Loss on Derivatives and Hedging Activities and Net Unrealized Gain and Loss, above, for additional discussion of the change in manner of accounting.

Other Expense. Other expense increased for the three and nine months ended September 30, 2004, compared to the same periods in 2003. Other expense primarily consists of operating expenses, which include staffing costs, facilities costs, professional fees, and other costs. Increases in salaries and benefits in the traditional member finance segment reflect higher staffing levels to address the increasingly complex nature of our regulatory environment.

Mortgage Purchase Program

The following table presents the components of our MPP segment results for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
(in thousands)				
Mortgage Purchase Program				
Net interest income	$ 5,979	$ 17,789	$ 39,335	$ 41,803
Other income (loss)	275	(3,536)	1,041	(3,679)
Other expense	(4,045)	(2,100)	(12,675)	(6,752)
Income before assessments	2,209	12,153	27,701	31,372
Assessments	(586)	(3,224)	(7,349)	(8,324)
Net income	$ 1,623	$ 8,929	$ 20,352	$ 23,048

Net Interest Income. Net interest income in the MPP segment decreased for the three and nine months ended September 30, 2004, compared to the same periods in 2003, primarily due to volatility in the premium amortization and changes in prepayment speeds of mortgage loans held for portfolio caused by fluctuations in interest rates. See Results of Operations – Interest Income, above, for additional discussion about interest income and average yields on the MPP.

Average yields on our mortgage loans held for portfolio were not impacted by credit losses for the three and nine months ended September 30, 2004 or 2003. We have not experienced any credit losses on our MPP investments since the program's inception. The conventional mortgage loans that we purchase under the MPP are credit-enhanced by our member institutions to a level equivalent to at least an investment-grade rating. Additionally, the conventional mortgage loans are covered by supplemental mortgage insurance sufficient to raise the credit quality of the loan pools to the equivalent of an AA rating. Based on our analysis

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of the mortgage loan portfolio, we have determined that the credit enhancements provided by the sellers and the supplemental mortgage insurance are currently sufficient to cover expected credit losses and that an allowance for credit loss is unnecessary.

Other Income (Loss). Other income (loss) for this segment includes fair value adjustments on our mortgage delivery commitments to purchase mortgage loans from participating financial institutions. Mortgage delivery commitments are derivative instruments that we record in our financial statements at fair value. Other income (loss) also includes pair-off fees, which are fees that we charge to participating financial institutions when the amount of loans they deliver to us differs from the committed amount.

Other Expense. Other expense increased for the three and nine months ended September 30, 2004, compared to the same periods in 2003. Other expense includes operating expenses and other infrastructure costs associated with the ongoing operations of the MPP. The expense increase reflects growth in our staffing, facilities, and information systems needed to support growth of the MPP segment.

Financial Condition

Advances

Advances decreased by $3.8 billion, to $15.8 billion, as of September 30, 2004, compared to December 31, 2003, due primarily to the maturity and non-renewal of approximately $3.7 billion of advances to two large member institutions. Larger member institutions ($3.0 billion and above in assets) generally have access to a broader range of funding sources at competitive rates, and changes in their borrowing decisions will impact the volume of advances outstanding. Our small and mid-size customers' aggregate advance volumes declined during the third quarter of 2004. However, their balances remain more stable when compared to the larger member institutions.

As of September 30, 2004, and December 31, 2003, five member institutions held approximately 53% and 61% of our outstanding advances. Two member institutions had advances totaling approximately 36% (one with 26% and another with 10%) of our outstanding advances as of September 30, 2004, compared to two member institutions with approximately 42% (one with 30% and another with 12%) as of December 31, 2003. No other member had more than 10% of advances outstanding during these periods. Because a large concentration of our advances are held by only a few member institutions, changes in their borrowing decisions may cause volatility in the amount of our advances outstanding.

Approximately 47% of the advances portfolio had a term-to-maturity of one year or less as of September 30, 2004, compared to approximately 50% as of December 31, 2003. The weighted average interest rate on the short-term advances with a term to maturity of one year or less was 2.20% as of September 30, 2004, and 1.81% as of December 31, 2003, which reflected the increase in interest rates during the second and third quarters of 2004. Short-term advances generally return a lower average yield and increase the potential for volatility as borrowers make renewal decisions more frequently.

Variable-rate advances accounted for 31.6%, or $4.9 billion, of advances outstanding as of September 30, 2004, and 36.7%, or $7.1 billion, as of December 31, 2003. Convertible advances, which are made at fixed rates, totaled approximately 20.7%, or $3.2 billion, of advances as of September 30, 2004, and 18.4%, or $3.6 billion, as of December 31, 2003. With a convertible advance, we effectively purchase a put option from the member, which allows us to terminate the fixed-rate advance prior to maturity. We could terminate a convertible advance for a number of reasons, including changes in interest rates, changes in the value of the embedded put option in the convertible advance, or other factors that may impact the value of the

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advance asset. If we should elect to terminate a convertible advance, we offer alternative funding at then current advance rates.

Member Institution Demand for Advances. Member institutions regularly evaluate financing options as their advances mature. Many factors affect the demand for advances, including changes in interest rates and changes in member institution needs. In a low interest-rate environment, our member institutions typically have less need for advances. Given the current interest-rate environment and our members' access to liquidity from customer deposits, we expect continued declines in advances in the near term. Our overall advances balance is dependent upon the borrowing decisions of a few large member institutions. If member institutions decide not to replace their maturing advances with new advances, we generally expect to reduce our consolidated obligations, subject to any restrictions on prepayment, and redeem our outstanding capital stock related to the maturing advances.

Some of our larger member institutions have operating subsidiaries that maintain memberships with other FHLBanks. When member institutions maintain membership in more than one FHLBank, they have the ability to select their advances from any of the FHLBanks where they are a member. Each FHLBank offers advance products that may have different repayment terms, collateral terms, or spreads to prevailing market rates such as LIBOR. An institution can select among the different FHLBanks of which it is a member to locate the repayment terms that are the most favorable to their needs. This competition among FHLBanks has contributed to the decrease in our advances, as larger member institutions draw new advances from other FHLBanks that offer different rate and credit terms. We regularly evaluate our product offerings and update them as needed to be competitive in the marketplace.

Credit Risk. As of September 30, 2004, we held $82.2 million of advances to two borrowers that we classified as substandard. These advances are fully collateralized with high-grade, marketable securities and rights to proceeds from mortgage loan collections. Because the borrowers continue to pay according to contractual requirements, and because of our collateral position, we continue to accrue interest on the advances.

We have never experienced a credit loss on an advance to a member. We have policies and procedures in place to appropriately manage our credit risk. Because of the collateral held as security on the advances and repayment history, we believe that an allowance for credit losses on advances is unnecessary.

Investments

The following table presents our investments as of September 30, 2004, and December 31, 2003.

(in thousands)	September 30, 2004	December 31, 2003
Investments		
Other FHLBanks' bonds	**$ 8,025,368**	$ 3,500,000
Mortgage-backed securities	**7,266,804**	7,245,569
U.S. agency obligations	**5,307,837**	5,569,228
Federal funds sold	**4,502,900**	2,506,500
Other	**1,204,171**	1,184,822
State or local housing agency obligations	**32,000**	41,273
Total	**$ 26,339,080**	$ 20,047,392

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Other FHLBanks' Consolidated Obligation Bonds. Our investments in other FHLBanks' consolidated obligation bonds increased by $4.5 billion, to $8.0 billion, as of September 30, 2004, compared to December 31, 2003. We invested in consolidated obligations issued by other FHLBanks to supplement investment income. Because our investments in the debt of Fannie Mae and Freddie Mac are near the limit of 100% limit of our capital, and our investments in mortgage-backed securities are near the limit of 300% of our capital, we have invested available funds in other FHLBank consolidated obligation bonds. We have discontinued the purchase of other FHLBank consolidated obligation bonds and are in the processing of reviewing our business strategies related to our investment portfolio. This decision may adversely impact the return we are able to earn on our investments in future periods.

Mortgage-Backed Securities. Our investment in mortgage-backed securities represented 293.6% and 295.1% of our total capital as of September 30, 2004, and December 31, 2003. Finance Board regulations limit each FHLBank's investment in mortgage-backed securities to 300% of a bank's capital. The mortgage-backed securities balances as of September 30, 2004, and December 31, 2003, consisted of $1.5 billion and $2.0 billion in Freddie Mac mortgage-backed securities, and $1.6 billion and $1.7 billion of investments in Fannie Mae mortgage-backed securities.

As of September 30, 2004, we held $687.0 million in mortgage-backed securities with unrealized losses of $22.7 million that have been in a continuous unrealized loss position for over 12 months. Based on the creditworthiness of the issuers and underlying collateral and our ability and intent to hold the investment until recovery, we believe that these unrealized losses represent temporary impairments. If these unrealized losses proved other than temporary, we could be required to establish an allowance for losses on these investments. A table summarizing the held-to-maturity securities with unrealized losses as of September 30, 2004, is included in Note 3 of the Condensed Notes to Financial Statements.

U.S. Agency Obligations. Our investments in U.S. agency obligations decreased by $261.5 million as of September 30, 2004, compared to December 31, 2003, primarily due to the maturity of two securities during the second quarter of 2004. Our U.S. agency obligations consisted of $2.5 billion and $2.3 billion of Fannie Mae debt securities as of September 30, 2004, and December 31, 2003, and $2.5 billion and $2.4 billion of Freddie Mac debt securities, respectively. Finance Board regulations limit our investments in the debt of any one government-sponsored enterprise (GSE) to 100% of our capital, with the exception of other FHLBank consolidated obligations.

Mortgage Loans Held for Portfolio

As of September 30, 2004, the MPP included 64 member institutions approved to participate, 29 of which have actively participated during the year, and three member institutions with applications in process, compared to 45, 25, and 10, as of December 31, 2003. Through September 30, 2004, we had purchased over 86% of our existing mortgage loans portfolio from one member institution and over 96% of our mortgage loans held for portfolio from three participating financial institutions. Consequently, changes in the volume of mortgages originated by these members are likely to cause volatility in the volume of mortgage loans we purchase under the MPP.

Our mortgage loans held for portfolio were $10.8 billion and $11.2 billion as of September 30, 2004, and December 31, 2003. This balance comprised $8.3 billion and $8.6 billion in conventional mortgage loans held as of September 30, 2004, and December 31, 2003, and $2.4 billion and $2.5 billion in government-insured mortgage loans.

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During 2004, we have been building our MPP infrastructure to improve our ability to serve our participating financial institutions. However, purchases of mortgage loans held for portfolio have been slower than we anticipated during 2004, reflecting the general slowdown in the overall U.S. mortgage market and a decision on our part to limit our purchases from large participating financial institutions until the infrastructure is in place to support those purchases.

During the third quarter of 2004, we submitted a new business application to the Finance Board for a new program called MortgageChoice. If this program is approved, we will be able to purchase mortgage securities from our member institutions and hold them as investments in our asset portfolio or resell them to other FHLBanks and other investors. MortgageChoice was developed to help foster additional growth in our mortgage business, enhance the bank's risk management capabilities, and offer our members a secondary mortgage market alternative.

Derivative Assets and Liabilities

As of September 30, 2004, and December 31, 2003, we had derivative assets of $32.3 million and $45.8 million and derivative liabilities of $292.6 million and $306.5 million. We record all derivative financial instruments on the statement of condition at their fair values. Accounting guidance requires that we record the change in fair value of all derivatives through earnings unless the derivative is designated and qualifies for hedge accounting treatment. Subject to certain qualifying conditions, we may designate a derivative as either a hedge of the change in the fair value of a fixed-rate instrument (fair value hedge) or a hedge of the cash flows of a variable-rate instrument or anticipated transaction (cash flow hedge). We currently do not have any derivatives designated as cash flow hedges. For a derivative designated as a fair value hedge, we report the gains and losses in the change in fair value on the derivative in earnings along with gains or losses on the hedged item attributable to the risk being hedged. For a derivative not designated as a hedge, not qualifying as a hedge, or components of a derivative that are excluded from any hedge ineffectiveness assessment, we report gains and losses in fair value through earnings.

Interest-rate exchange agreements are derivative instruments, and we classify them as derivative assets or liabilities according to the net fair value of the derivatives with each counterparty. If the net fair value of the derivatives with a counterparty is positive, it is classified as an asset; if the net fair value of the derivatives with a counterparty is negative, it is classified as a liability. Increases and decreases in the fair value of an interest-rate exchange agreement are caused by increases and decreases in interest rates that translate into changes in the fair value.

Consolidated Obligations and Other Funding Sources

We fund our operations primarily with proceeds from the issuance of consolidated obligations in the financial markets. Other funding sources are member deposits, capital, short-term investments and, to a lesser extent, repurchase agreements. We make significant use of interest-rate exchange agreements to restructure interest rates on consolidated obligations to better match our funding needs and to reduce funding costs. We are able to obtain favorable funding for our operations because of our ability to access the financial markets, particularly through the sale of consolidated obligations across the entire maturity spectrum and through a variety of debt structures.

Finance Board regulations govern the issuance of debt on behalf of the FHLBanks, and the Office of Finance is responsible for issuing and servicing consolidated obligations. There are two forms of consolidated

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obligations: discount notes and bonds. Under the FHLB Act, all of the FHLBanks are jointly and severally liable for the consolidated obligations issued. We record our allocated portion of the combined consolidated obligations, but we do not record our joint and several liability, relative to the other FHLBanks' consolidated obligations, on our statement of condition, because its occurrence is conditional on the default of another FHLBank. To do so, we would have to be able to determine the probability of default of each of the other FHLBanks and evaluate that probability against the particular FHLBank's debt level. We consider the possibility that one of the FHLBanks would be unable to repay its participation to be remote.

The FHLB Act does not permit individual FHLBanks to issue individual debt without Finance Board approval. We have not issued any such debt.

Consolidated Obligation Discount Notes. Consolidated obligation discount notes have maturities of up to 360 days and are a significant funding source for advances with short-term maturities or short repricing intervals, for convertible advances, and for money-market investments. Discount notes are sold at a discount to par, and they mature at par. Our allocated portion of the combined consolidated obligation discount notes outstanding was $5.9 billion and $6.6 billion as of September 30, 2004, and December 31, 2003.

Consolidated Obligation Bonds. Consolidated obligation bonds satisfy long-term funding requirements and have maturities ranging from one year to 20 years. The maturity terms are not subject to any statutory or regulatory limit. Consolidated obligation bonds can be issued and distributed through negotiated or competitively bid transactions with approved underwriters or selling group members. We use a number of different structures and maturity terms to meet our funding needs. Our allocated portion of the combined consolidated obligation bonds outstanding was $42.7 billion and $39.9 billion as of September 30, 2004, and December 31, 2003. Refer to Note 7 of the Condensed Notes to Financial Statements for additional information on consolidated obligation bonds.

We actively manage our debt portfolio to closely match the anticipated cash flows of our assets. The cash flows of mortgage loans and investments are dependent in part on borrower prepayment behavior. If mortgage interest rates rise, mortgage-based assets typically remain outstanding for a longer period of time. Likewise, when mortgage interest rates fall, mortgage loans tend to be prepaid, and our balances decline faster than originally expected. We seek to manage these changes in our outstanding balances by using a combination of callable and non-callable debt to closely match the expected principal balances outstanding on our mortgage-based assets, under a variety of expected prepayment scenarios. With callable debt, we have the option to repay the obligation, without penalty, prior to the contractual maturity date of the debt obligation. We would generally elect to repay the debt when interest rates fall and refinance the debt at lower rates.

Other Liabilities

Other liabilities decreased by $69.8 million as of September 30, 2004, compared to December 31, 2003. Other liabilities as of September 30, 2004 and December 31, 2003, primarily included $45.0 million and $119.9 million of investments purchased but not settled.

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Capital, Retained Earnings, Dividends, and Statutory Capital Requirements

Capital. Our capital increased by 0.8%, to $2.5 billion, as of September 30, 2004, compared to December 31, 2003. Member stock requirements are based, in part, on members' volume of activity with the Seattle Bank, as discussed below. Class B(1) stock decreased by $89.5 million, to $2.2 billion, as of September 30, 2004, compared to $2.3 billion as of December 31, 2003. Class B(2) stock increased by $108.0 million, to $221.5 million, as of September 30, 2004, compared to $113.5 million as of December 31, 2003, as Class B(1) stock was converted to Class B(2) due to limits on the amount of excess Class B(1) stock that a member can hold.

Our capital plan provides for two classes of Class B stock, each of which has a par value of $100 per share. Each class of stock is issued, redeemed, and repurchased only at par value. Members are required to hold Class B(1) stock equal to the sum of: (1) 3.5% of the member's outstanding principal balance of advances; (2) the greater of $500 or 0.75% of the member's home mortgage loans; and (3) 5.0% of the outstanding principal balance of loans that the member has sold to the Seattle Bank under the MPP, minus the amount in (2) above (cannot be less than 0). Members can also hold some amount of Class B(1) stock in excess of the required balance under certain circumstances. Members cannot purchase Class B(2) stock and are not required to hold any amount of Class B(2) stock. Any Class B(1) stock held by members that exceeds the permitted amount of Class B(1) stock will automatically convert to Class B(2) stock five days after the Seattle Bank notifies the member of that conversion. We monitor our members' activity-based stock requirements and notify members of any changes.

During the third quarter of 2004, we reviewed our capital plan and determined that modifications were appropriate. These modifications include an amendment that would permit a change in the timing of our dividend declaration and payment dates, and a change to how we pay dividends on stock that has been redeemed during the quarter. Our Board of Directors approved the revised capital plan in September 2004. In October 2004, the revised capital plan was submitted to the Finance Board for review and approval.

Class B(1) and Class B(2) Stock Redemption Requests. Subsequent to September 30, 2004, we repurchased $107.7 million of Class B(1) stock and $229.5 million of Class B(2) stock. Of these repurchases, $81.6 million of Class B(1) stock was repurchased from two member institutions, and all of the Class B(2) stock was repurchased from a third member institution. Each of these institutions had executives who serve on our Board of Directors. Member institutions can elect to redeem their stock with five years' notice. We can repurchase stock prior to the expiration of the five-year notice period, at our discretion, as long as we are in compliance with Finance Board minimum capital level requirements. It has been our practice to repurchase stock soon after we receive the request from our member institutions. However, if granting the request would bring our capital levels out of compliance with Finance Board requirements, we would defer the payment on the redemption request until sufficient capital levels were available to support the redemption request.

We reviewed our capital requirements and determined that granting the redemption requests for Class B(1) stock and Class B(2) stock in these amounts would not affect our compliance with Finance Board minimum capital level requirements. Based on this determination, we processed these redemption requests and we returned the capital to the member institutions in October 2004.

Large Member Institution State Charter Consolidation. Subsequent to September 30, 2004, one of our large member institutions announced that it intends to merge into one of its affiliated institutions. It is not known at this time what impact the proposed merger will have on our operations.

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Retained Earnings. Retained earnings increased by 2.1%, to $58.0 million, as of September 30, 2004, compared to $57.2 million as of December 31, 2003. The increase of $0.9 million for the nine months ended September 30, 2004, resulted from net income of $65.2 million less dividends paid to member institutions of $64.3 million.

Retained Earnings Policy and Target Level of Retained Earnings. In 2003, the Finance Board issued guidance to the FHLBanks calling for each FHLBank, at least annually, to assess the adequacy of its retained earnings in light of alternative possible future financial and economic scenarios, including parallel and non-parallel interest-rate shifts, changes in the basis relationship between different yield curves, and changes in the credit quality of the FHLBank's assets. Each FHLBank's board of directors is expected to adopt a retained earnings policy that includes a target level of retained earnings, as well as a plan that will enable the FHLBank to reach the target level of retained earnings.

In April 2004, the Seattle Bank's Board of Directors adopted a retained earnings policy and a target level of retained earnings. The new target level of retained earnings of $35.0 million was intended to help cushion our earnings volatility due to the application of certain accounting principles, including volatility caused by changes in the fair value of derivatives and amortization of premiums and accretion of discounts on mortgage-based products. The underlying assumption of the policy was that if our retained earnings were not sufficient to cover the volatility in our earnings due to the application of accounting principles, including volatility stemming from operational, credit, and interest-rate risk, holders of our Class B stock would absorb all remaining losses.

In September 2004, the Seattle Bank's Board of Directors adopted a revised retained earnings policy and increased its target level of retained earnings following further guidance from the Finance Board. Under this revised retained earnings policy, we increased the target level of retained earnings from $35.0 million to $89.0 million. The Finance Board is currently reviewing our revised policy and may require us to again increase our level of retained earnings, which would further impact future dividends. Because of the change in the retained earnings policy, it is likely that our annualized dividend rate for the fourth quarter of 2004 will be less than the rate paid for the third quarter of 2004. We also expect that the annual dividend rate over the next three years could be at least 50 basis points lower than historical levels, as we build our retained earnings balance toward the new target level.

Since 2002, we have steadily increased our level of retained earnings to help cushion against volatility of earnings due to the application of accounting guidance implemented in recent years. Our capital levels continue to exceed our minimum regulatory requirement.

Dividends. We may pay dividends from current income and retained earnings. Our Board of Directors may declare and pay dividends in either cash or capital stock. Dividends on Class B(1) stock totaled $19.2 million, and dividends on Class B(2) stock totaled $602,000 for the three months ended September 30, 2004. For the nine months ended September 30, 2004, dividends declared and paid on Class B(1) stock totaled $63.0 million, and dividends on Class B(2) stock totaled $1.3 million. As of September 30, 2004, the 2004 annualized dividend rate for Class B(1) stock was 3.83% and for Class B(2) stock was 0.84%, compared to 5.74% and 0.72% for the same period in 2003, reflecting our results of operations for these periods.

Although we expect to continue paying dividends in the foreseeable future, payment of future dividends is subject to the discretion of our Board of Directors and satisfaction of regulatory requirements. The amount and timing will depend on many factors, including our financial condition, earnings, capital requirements, retained earnings policy, regulatory constraints, legal requirements, and other factors that our Board of Directors deem relevant. As discussed above, we expect our revised retained earnings policy adopted in

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September 2004 to reduce our future dividends rates by at least 50 basis points for the next three years, as we build our retained earnings to meet the target level of $89.0 million.

We review our dividend payment policy periodically to determine if modifications are needed. During 2004 and 2003, our Board of Directors declared dividends in the form of stock only, with cash paid for any fractional shares.

The following table presents the dividends paid in 2004 and 2003 on Class B(1) stock.

	2004		2003	
	Amount	Annualized Dividend Rate	Amount	Annualized Dividend Rate
(in thousands, except annualized dividend rate data)				
Class B(1) Stock				
First Quarter	**$ 22,120**	**4.00%**	$ 35,005	6.75%
Second Quarter	**21,675**	**4.00%**	28,448	5.25%
Third Quarter	**19,224**	**3.50%**	29,659	5.25%
Fourth Quarter			28,636	5.00%
Total	**$ 63,019**	**3.83%**	$ 121,748	5.56%

The following table represents the dividends paid in 2004 and 2003 on Class B(2) stock.

	2004		2003	
	Amount	Annualized Dividend Rate	Amount	Annualized Dividend Rate
(in thousands, except annualized dividend rate data)				
Class B(2) Stock				
First Quarter	**$ 276**	**0.64%**	$ 449	0.79%
Second Quarter	**437**	**0.77%**	412	0.73%
Third Quarter	**602**	**1.10%**	324	0.65%
Fourth Quarter			200	0.67%
Total	**$ 1,315**	**0.84%**	$ 1,385	0.71%

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Statutory Capital Requirements. We are subject to three statutory capital requirements. As of September 30, 2004, and December 31, 2003, we were in compliance with these statutory capital requirements. These requirements are as follows:

First, we are required to hold risk-based capital equal to the sum of our credit-risk requirement, market-risk requirement, and operations-risk requirement, calculated in accordance with Finance Board regulations. Only permanent capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. The Finance Board has the authority to require the Seattle Bank to maintain a greater amount of permanent capital than is required by the risk-based capital requirements, as defined, but has not done so.

(in thousands)	September 30, 2004	December 31, 2003
Permanent Capital		
Class B(1) stock	$ 2,195,514	$ 2,285,032
Class B(2) stock	221,454	113,473
Retained earnings	58,049	57,177
Permanent capital	$ 2,475,017	$ 2,455,682
Risk-Based Capital Requirement		
Credit-risk capital	$ 220,538	$ 172,940
Market-risk capital	344,295	361,599
Operations-risk capital	169,450	160,362
Risk-based capital requirement	$ 734,283	$ 694,901

Second, the Gramm-Leach-Bliley Act (GLB Act) imposes a 5% minimum leverage ratio based on total capital, which includes a 1.5 weighting factor applicable to permanent capital. A minimum leverage ratio, which is defined as total capital (with permanent capital multiplied by 1.5) divided by total assets, is intended to ensure that the Seattle Bank maintains a sufficient amount of capital to service our debt. The leverage ratio measures the degree to which we use debt. Leverage ratios at or near the 5% minimum would indicate that we have reached our maximum capacity to issue debt, and leverage ratios that exceed the 5% minimum indicate that we have additional capacity to fund operations through debt.

(in thousands, except ratio data)	September 30, 2004	December 31, 2003
Leverage Ratio		
Minimum leverage capital (5% of total assets)	$ 2,660,388	$ 2,558,191
Leverage capital (includes 1.5 weighting factor applicable to permanent capital)	3,712,526	3,683,523
Leverage ratio (leverage capital as a percentage of total assets)	7.0%	7.2%

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Third, the GLB Act imposes a 4% minimum capital ratio, defined as total capital over total assets, that does not include the 1.5 weighting factor applicable to permanent capital. We use the capital ratio measure to monitor our operations. Capital ratios at or near the 4% minimum would indicate that we have fully utilized our capital resources to run our operations, and capital ratios that exceed the 4% minimum indicate that we have additional capacity to grow our asset base to increase earnings capacity.

(in thousands, except ratio data)	September 30, 2004	December 31, 2003
Capital Ratio		
Minimum capital (4% of total assets)	**$ 2,128,311**	$ 2,046,553
Capital ratio (permanent capital as a percentage of total assets)	**4.7%**	4.8%

Liquidity

We serve the public by enhancing the availability of credit to our member institutions for residential mortgage loans and targeted community development. We are required to maintain liquidity in accordance with Finance Board regulations and policies established by our Board of Directors. We actively manage our liquidity to preserve stable, reliable, and cost-effective sources of cash to meet all current and future normal operating financial commitments.

In their asset/liability management planning, member institutions may look to the Seattle Bank to provide standby liquidity. We seek to be in a position to meet our member institutions' credit and liquidity needs without maintaining excessive holdings of low-yielding liquid investments or being forced to incur unnecessarily high borrowing costs. Our primary sources of liquidity are short-term investments and new consolidated obligations. Other short-term borrowings, including federal funds purchased, securities sold under agreements to repurchase, and loans from other FHLBanks, provide additional liquidity. To ensure that adequate liquidity is available to meet our cash requirements, we monitor and forecast our future cash flows and our members' liquidity needs, and we adjust funding and investment strategies as needed.

Through the issuance of consolidated obligations, we have ready access to funding at relatively favorable spreads to U.S. Treasury rates. However, the U.S. government does not guarantee FHLBank debt.

We maintain contingency liquidity plans designed to enable us to meet our obligations and the liquidity needs of our members in the event of operational disruptions at the Seattle Bank or the Office of Finance, or in the event of short-term financial market disruptions. These include back-up funding sources in the repurchase and federal funds markets. We continuously monitor our liquidity position and anticipated funding requirements. If an operational disruption should occur in which the Bank System were not able to issue consolidated obligations, we could borrow against our held-to-maturity investment portfolio to meet funding needs.

Quantitative and Qualitative Disclosures About Market Risk

Our operating segments provide our member institutions and housing associates with advances and other credit products with a wide range of maturities and terms and provide our members with an alternative funding source in the secondary mortgage market. The principal sources of funds for these activities are consolidated obligations and, to a lesser extent, capital and deposits from member institutions. Lending and investing funds and engaging in interest-rate exchange agreements may expose us to a number of risks, including credit, interest-rate, operational, and business risks. We have established policies and practices to evaluate and control these risks. In addition, the Finance Board has established regulations governing our risk management practices, and we file periodic compliance reports with the Finance Board.

We do not currently have any special purpose entities or any other type of off-balance sheet arrangements. We record all derivatives in the statement of condition at fair value. Finance Board regulations prohibit the speculative use of interest-rate exchange agreements, and we do not trade derivatives for short-term profit.

Interest-Rate Risk Management

Interest-rate risk is the risk of loss to future earnings or long-term value that may result from changes in interest rates.

We use duration as the primary means to measure our exposure to changes in interest rates. Duration is the weighted-average maturity (typically measured in months or years) of an instrument's cash flows, weighted by the present value of those cash flows. Duration measures the time required to recapture an investment, reinvesting repaid principal. As duration lengthens, the risk increases. Duration is also a measure of price volatility.

We measure interest-rate risk exposure by a variety of risk measurement methods and analyses, including calculation of the effective duration of equity, duration gap, and market value of equity sensitivity. Each of these methods provides different statistical information we use to effectively manage our interest-rate risks. Management uses rebalancing actions based on a number of factors that include these measurement methods. These measurement methods are described in more detail below.

Duration of Equity. Duration of equity is the market-value-weighted effective duration of assets minus the market-value-weighted effective duration of liabilities, plus the market-value-weighted duration of off-balance sheet items, divided by the market value of equity. In this calculation, we consider all components of capital as equity. Duration of equity shows the sensitivity of market value of equity to instantaneous changes in interest rates. Effective duration approximates the percentage change in the value of a financial instrument, given a shift in the yield curve. Higher duration numbers, whether positive or negative, indicate greater potential volatility of the market value of equity.

The value of an instrument with a duration of five years will change by approximately 5% with a 100-basis-point instantaneous change in interest rates. Our current policy, adopted by our Board of Directors, was developed in accordance with Finance Board regulations. Under this policy, duration of equity must stay within a range of +5 to -5 years when measured using current interest rates, and must stay within a range of +7 to -7 years when measured under an instantaneous parallel increase or decrease in interest rates of 200 basis points. As of September 30, 2004, duration of equity was within policy parameters established by our Board of Directors in the base case and for the up 200 basis point shock scenario. However, in the down scenario, duration was –9.8 years, which exceeded the guideline of -7 years. This resulted from the restructuring of our consolidated obligation bonds as we replaced callable debt with lower cost non-callable debt (bullet debt). The duration of the bullet debt contracts as interest rates decrease, but not enough to offset the contraction of our mortgage-based assets.

Quantitative and Qualitative Disclosures About Market Risk

CONTINUED

During October 2004, we purchased swaptions (options to enter into interest-rate swap agreements) with notional amounts totaling $1.0 billion to help reduce our duration of equity in the down 200 basis point scenario. As of October 31, 2004, our duration of equity in the down scenario was –5.9 years, which was in compliance with our duration of equity guidelines.

As required under Finance Board guidance, we are permitted to adjust the instantaneous parallel decrease when a decrease of 200 basis points would result in short-term rates below zero. Based on this guidance, we adjusted the instantaneous parallel decrease to approximately 156 basis points as of October 31, 2004, 136 basis points as of September 30, 2004, and 60 basis points as of December 31, 2003.

The following table summarizes the interest-rate risk associated with our financial instruments outstanding as of September 30, 2004, and December 31, 2003, based on the duration of equity in years.

(in years)	September 30, 2004	December 31, 2003
Duration of Equity		
Up 200 basis points	**6.4**	6.4
Base Case	**1.5**	4.1
Down: 136 basis points – September 30, 2004	**(9.8)**	
60 basis points – December 31, 2003		3.2

The decrease in the base case (i.e., using current interest rates) duration of equity to 1.5 years as of September 30, 2004, compared to 4.1 years as of December 31, 2003, was primarily due to a decrease in the duration of our mortgage-based assets as long-term interest rates decreased, and projected prepayment speeds of mortgage-based assets accelerated. As of September 30, 2004, at current interest rate levels, and under current prepayment modeling assumptions, our duration of equity is significantly more sensitive to further contraction if interest rates decrease, compared to December 31, 2003. Our projected duration of equity in the down 136 basis point compliance scenario was –9.8 years as of September 30, 2004, compared to 3.2 years as of December 31, 2003 in a down 60 basis point scenario. This sensitivity to duration contraction as interest rates decrease is the result of the restructuring of the consolidated obligation bonds portfolio, increasing the weight of bullet debt relative to callable debt. The duration of the overall consolidated obligation bonds portfolio contracts as interest rates decrease, but not enough to offset the contraction of our mortgage-based assets.

Duration Gap. Duration gap measures the difference between the estimated durations of portfolio assets and liabilities and summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time and across interest rate scenarios. A positive duration gap signals a greater exposure to rising interest rates because it indicates that the duration of our assets exceeds the duration of our liabilities. A negative duration gap signals a greater exposure to declining interest rates because the duration of our assets is less than the duration of our liabilities. We actively manage the duration gap to help preserve the financial strength of the Seattle Bank at all times, including during periods of significant market volatility.

Quantitative and Qualitative Disclosures About Market Risk

CONTINUED

The following table summarizes the range of our duration gap in months between our assets and liabilities.

(in months)	September 30, 2004	December 31, 2003
Duration Gap		
From	**0.9**	(2.9)
To	**2.0**	1.3

Market Value of Equity Sensitivity. Market value of equity is defined as the present value of the expected net cash flows from all assets, liabilities, and off-balance sheet instruments. Our market value of equity is sensitive to changes in interest rates primarily because of mismatches in the maturities and embedded options associated with our mortgage-based assets and the consolidated obligation bonds we use to fund these assets. We evaluate our market value sensitivity, on an ongoing basis, under a variety of parallel and non-parallel shock scenarios. The resulting risk profile provides a general indicator of our exposure to interest-rate risk from a market value perspective. It also provides a rough indicator of earnings exposure to long-term repricing gaps and options positions in our statement of condition.

For policy compliance purposes, market value of equity in the up-and-down-200-basis-point shock scenarios is compared to the market value of equity in the base case. Through the policy adopted by our Board of Directors, the largest negative change in market value after applying the up and down shock scenarios may not exceed 20% of the base case. We were in compliance with this policy throughout the nine months ended September 30, 2004. As with duration of equity, a shock of 136 basis points was used for the September 30, 2004 down scenario, since the down-200-basis-point rate shock scenario would result in interest rates below zero.

The following table summarizes the range of our market value of equity sensitivity as of September 30, 2004, and December 31, 2003.

(in thousands)	September 30, 2004	December 31, 2003
Market Value of Equity Sensitivity		
Up 200 basis points	**$ 1,982,396**	$ 1,957,414
Base Case	**2,134,748**	2,211,053
Down: 136 basis points – September 30, 2004	**2,062,928**	
60 basis points – December 31, 2003		2,208,954

The base case market value of equity dropped slightly as of September 30, 2004, compared to December 31, 2003, mostly as the result of the decrease in our advances and mortgage-based securities balances. As of September 30, 2004, our market value risk profile showed slightly less exposure in percentage terms to the up-200-basis-point shock than it did as of December 31, 2003. With the increase in long-term interest rates during 2004, we are slightly less sensitive to additional upward rate moves and more sensitive to downward moves. We intend to evaluate the existing policy during the remainder of 2004 and 2005 to determine whether and to what extent, it would be beneficial to decrease the sensitivity limits.

Quantitative and Qualitative Disclosures About Market Risk

CONTINUED

Interest-Rate Exchange Agreements

We use interest-rate exchange agreements, such as interest rate swaps, interest rate caps and floors, and forward purchase and sale agreements, to manage our exposure to changes in interest rates. This enables us to adjust the effective maturity, repricing frequency, or option characteristics of our assets and liabilities in response to changing market conditions. Total notional (face) amount of interest-rate exchange agreements outstanding was $14.2 billion as of September 30, 2004, compared to $17.5 billion as of December 31, 2003. The notional amount of these agreements serves as a factor in determining periodic interest payments or cash flows received and paid, and does not represent actual amounts exchanged or our exposure to credit or market risk. Therefore, the notional amount is significantly greater than the potential market or credit loss that could result from such transactions. Notional values are not meaningful measures of the risks associated with interest-rate exchange agreements or other derivatives, which can only be meaningfully measured on a market-value basis, taking into consideration the cost of replacing interest-rate exchange agreements with similar agreements from a highly rated counterparty.

As of September 30, 2004, and December 31, 2003, our maximum credit risk on interest-rate exchange agreements, before considering collateral, was approximately $29.1 million and $45.2 million. In determining maximum credit risk, we consider accrued interest receivables and payables, and the legal right to offset assets and liabilities by counterparty. Our net exposure after considering collateral was approximately $17.1 million as of September 30, 2004, and $25.1 million as of December 31, 2003. We have never experienced a loss on a derivative transaction due to credit default by a counterparty. We believe that the credit risk on our interest-rate exchange agreements is low because we contract with experienced counterparties that are of very high credit quality. Excluding interest-rate exchange agreements in which we are an intermediary for member institutions and which are fully collateralized, almost 100%, as of September 30, 2004, and approximately 96%, as of December 31, 2003, of the notional amount of our outstanding interest-rate exchange agreements are with counterparties with credit ratings of “A” or higher.

Derivative Financial Instruments

We report all derivative financial instruments on the statement of condition at their fair value. We classify derivative assets and derivative liabilities according to the net fair value of derivatives with each counterparty. If the net fair value of derivatives with a counterparty is positive, the net amount is classified as an asset; if the net fair value of derivatives with a counterparty is negative, it is classified as a liability. As of September 30, 2004, and December 31, 2003, we held derivative assets of $32.3 million and $45.8 million and derivative liabilities of $292.6 million and $306.5 million.

Quantitative and Qualitative Disclosures About Market Risk

CONTINUED

The following table categorizes the estimated fair value of derivative financial instruments, excluding accrued interest, by product and type of accounting treatment. Under "Fair Value," we include derivative instruments where hedge accounting is achieved. In a fair value hedge, the changes in fair value of the hedged item and the derivative offset each other, resulting in little or no impact to earnings. Under "Economic," we include hedge strategies where derivative hedge accounting is not applied and, therefore, changes in the fair value of the derivatives are recorded in current-period earnings with no adjustments made to the economically hedged asset or liability.

	September 30, 2004			December 31, 2003		
(in thousands)	Notional	Estimated Fair Value (excludes accrued interest)	Hedged Item Fair Value (excludes accrued interest)	Notional	Estimated Fair Value (excludes accrued interest)	Hedged Item Fair Value (excludes accrued interest)
Advances						
Fair Value	$ 3,330,057	$ (187,835)	$ 187,835	$ 3,372,309	$ (254,844)	$ 254,844
Investments						
Economic	200,000	(53,012)	50,875*	200,000	(48,522)	44,187*
Mortgage Loans Held for Portfolio						
Fair Value	180,000	(266)				
Standalone delivery commitments	17,553	(34)		612,674	(2,736)	
Economic	11,000	33		746,000	2,061	
Consolidated Obligation Bonds						
Benchmark Fair Value	8,924,195	(50,778)	46,422	10,728,495	4,038	(4,035)
Statement of Condition						
Economic	700,000	2,821		700,000	6,185	
Intermediary Positions						
Intermediaries	856,800	91		1,134,800	151	
Total	$ 14,219,605	$ (288,980)	$ 285,132	$ 17,494,278	$ (293,667)	$ 294,996
Accrued Interest		28,735			32,920	
Net Derivative Balance		$ (260,245)			$ (260,747)	
Derivative Balance						
Assets		$ 32,332			$ 45,766	
Liabilities		(292,577)			(306,513)	
Net derivative balance		$ (260,245)			$ (260,747)	

** Fair value adjustment on securities held at fair value.*

Refer to our 2003 Annual Report for additional discussion about Quantitative and Qualitative Disclosures about Market Risk.

Legal Proceedings and Other

Legal Proceedings

From time to time, the Seattle Bank is subject to legal proceedings arising in the normal course of business. After consultations with legal counsel, we do not anticipate any liability that may arise out of current matters will have a material impact on our financial condition, results of operations, or cash flows.

Other

On October 25, 2004, we announced the resignation of Kelli L. Bono, Executive Vice President and Chief Financial Officer, effective December 1, 2004. We have appointed an interim chief financial officer and have engaged a leading financial search firm to help us fill the chief financial officer position.

Statements of Condition

(Unaudited)	September 30, 2004	December 31, 2003
(In thousands, except par value data)		
Assets		
Cash and due from banks	$ 3,514	$ 4,313
Interest-bearing deposits	940,000	770,000
Securities purchased under agreements to resell		100,000
Federal funds sold	4,502,900	2,506,500
Investments:		
Held-to-maturity securities (Note 3)	20,645,305	16,426,705
Securities held at fair value (Note 4)	250,875	244,187
Advances (Note 5)	15,819,614	19,652,566
Mortgage loans held for portfolio (Note 6)	10,782,052	11,171,517
Accrued interest receivable	207,368	222,045
Premises and equipment, net	8,439	5,259
Derivative assets	32,332	45,766
Other assets	15,364	14,957
Total Assets	$ 53,207,763	$ 51,163,815
Liabilities and Capital		
Liabilities		
Deposits:		
Demand and overnight	$ 1,103,121	$ 1,125,313
Term	135,079	171,325
Other	12,023	20,100
Total deposits	1,250,223	1,316,738
Consolidated obligations, net (Note 7):		
Discount notes	5,915,797	6,609,074
Bonds	42,725,305	39,909,274
Total consolidated obligations	48,641,102	46,518,348
Accrued interest payable	434,427	374,298
Affordable Housing Program	45,485	48,368
Payable to Resolution Funding Corporation	3,853	9,065
Derivative liabilities	292,577	306,513
Other liabilities	65,079	134,878
Total liabilities	50,732,746	48,708,208
Capital (Note 8 and 11)		
Class B stock ($100 par value) issued and outstanding shares:		
Class B(1) stock: 21,955 and 22,850	2,195,514	2,285,032
Class B(2) stock: 2,214 and 1,134	221,454	113,473
Retained earnings	58,049	57,177
Accumulated other comprehensive income:		
Unrealized loss related to hedging activities		(75)
Total capital	2,475,017	2,455,607
Total Liabilities and Capital	$ 53,207,763	$ 51,163,815

See condensed notes to financial statements.

Statements of Income

(Unaudited)	For the Three Months Ended September 30, 2004	For the Three Months Ended September 30, 2003	For the Nine Months Ended September 30, 2004	For the Nine Months Ended September 30, 2003
(In thousands, except per share and annualized dividend rate data)				
Interest Income				
Advances (Note 5)	$ 106,592	$ 130,186	$ 314,151	$ 399,825
Interest-bearing deposits	5,167	2,306	10,973	7,705
Securities purchased under agreements to resell	183	344	558	1,256
Federal funds sold	10,847	5,519	22,965	23,367
Investments:				
Held-to-maturity securities (Note 3)	166,807	114,620	456,179	390,891
Securities held at fair value (Note 4)	3,625	3,625	10,875	10,875
Mortgage loans held for portfolio (Note 6)	130,161	110,506	413,402	321,619
Other	9	1	9	40
Total interest income	423,391	367,107	1,229,112	1,155,578
Interest Expense				
Consolidated obligations (Note 7)	383,175	322,497	1,100,182	989,721
Deposits	3,578	4,383	8,612	14,506
Other borrowings		6	3	105
Total interest expense	386,753	326,886	1,108,797	1,004,332
Net Interest Income	36,638	40,221	120,315	151,246
Other Income (Loss)				
Prepayment fees	408	8,364	660	9,783
Service fees	559	644	1,717	1,780
Net realized gain on sale of held-to-maturity securities	1,195	9,423	2,818	19,660
Net unrealized gain (loss) on securities held at fair value	14,375	(12,781)	6,687	(1,250)
Net realized and unrealized gain (loss) on derivatives and hedging activities	(19,989)	10,701	(10,524)	(8,913)
Other, net	(252)	61	(201)	442
Total other income (loss)	(3,704)	16,412	1,157	21,502
Other Expense				
Operating	8,751	7,120	28,608	20,205
Federal Housing Finance Board	502	490	1,363	1,469
Office of Finance	232	208	854	804
Other	625	438	1,894	1,524
Total other expense	10,110	8,256	32,719	24,002
Income Before Assessments	22,824	48,377	88,753	148,746
Assessments				
Affordable Housing Program	1,863	3,949	7,245	12,143
Resolution Funding Corporation	4,192	8,886	16,302	27,321
Total assessments	6,055	12,835	23,547	39,464
Net Income	$ 16,769	$ 35,542	$ 65,206	$ 109,282
Earnings per share	$ 0.70	$ 1.46	$ 2.71	$ 4.57
Average number of shares of Class B(1) and Class B(2) stock outstanding	24,022	24,397	24,021	23,910
Annualized dividend rate on Class B(1) stock	3.50%	5.25%	3.83%	5.74%
Annualized dividend rate on Class B(2) stock	1.10%	0.65%	0.84%	0.72%

See condensed notes to financial statements.

Statements of Capital

(Unaudited)	Class B(1) stock		Class B(2) stock		Retained Earnings	Accumulated Other Comprehensive Income	Total Capital
	Shares	Par Value	Shares	Par Value			
(In thousands, except annualized dividend rate data)							
Balance as of December 31, 2002	20,911	$ 2,091,138	2,541	$ 254,186	$ 36,540	$ 280	$ 2,382,144
Issuance of stock	801	80,125					80,125
Redemption of stock	(840)	(84,028)	(78)	(7,865)			(91,893)
Transfers	1,251	125,119	(1,251)	(125,119)			
Comprehensive income:							
Net Income					109,282		109,282
Other comprehensive income:							
Reclassification adjustment for gain on hedging activities included in net income						(390)	(390)
Comprehensive income					109,282	(390)	108,892
Dividends on stock:							
Class B(1) stock (5.74%)							
Class B(2) stock (0.72%)							
Cash					(67)		(67)
Stock	931	93,055	12	1,176	(94,231)		
Balance as of September 30, 2003	23,054	$ 2,305,409	1,224	$ 122,378	$ 51,524	$ (110)	$ 2,479,201
Balance as of December 31, 2003	22,850	$ 2,285,032	1,134	$ 113,473	$ 57,177	$ (75)	$ 2,455,607
Issuance of stock	819	81,936					81,936
Redemption of stock	(1,264)	(126,385)	(13)	(1,356)			(127,741)
Transfers	(1,080)	(108,031)	1,080	108,031			
Comprehensive income:							
Net Income					65,206		65,206
Other comprehensive income:							
Reclassification adjustment for loss on hedging activities included in net income						75	75
Comprehensive income					65,206	75	65,281
Dividends on stock:							
Class B(1) stock (3.83%)							
Class B(2) stock (0.84%)							
Cash					(66)		(66)
Stock	630	62,962	13	1,306	(64,268)		
Balance as of September 30, 2004	21,955	$ 2,195,514	2,214	$ 221,454	$ 58,049	$	$ 2,475,017

See condensed notes to financial statements.

Statements of Cash Flows

(Unaudited) (In thousands)	For the Nine Months Ended September 30, 2004	2003
Operating Activities		
Net income	$ 65,206	$ 109,282
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization:		
Net premiums and discounts on consolidated obligations, investments, mortgage loans held for portfolio, and deferred costs and fees received on interest-rate exchange agreements	6,697	11,704
Concessions on consolidated obligation bonds	7,021	13,883
Premises and equipment	1,354	827
Other	74	(390)
Net realized (gains) losses on sales of held-to-maturity securities	(2,818)	(19,660)
Decrease (increase) on securities held at fair value	(6,687)	1,250
Loss (gain) due to change in net fair value adjustment on derivatives and hedging activities	(3,059)	48,826
Decrease (increase) in accrued interest receivable	14,677	61,477
Decrease (increase) in net accrued interest on derivative assets	1,704	(7,783)
Increase (decrease) in net accrued interest on derivative liabilities	2,482	(1,354)
Decrease (increase) in other assets	(7,108)	(16,207)
Net increase (decrease) in Affordable Housing Program (AHP) liability and discount on AHP advances	(2,883)	(4,223)
Increase (decrease) in accrued interest payable	60,129	28,358
Increase (decrease) in payable to Resolution Funding Corporation	(5,212)	(2,300)
Increase (decrease) in other liabilities	5,101	24,750
Total adjustments	71,472	139,158
Net cash provided by operating activities	$ 136,678	$ 248,440
Investing Activities		
Net decrease (increase) in interest-bearing deposits	$ (170,000)	$ (205,015)
Net decrease (increase) in securities purchased under agreements to resell	100,000	200,000
Net decrease (increase) in federal funds sold	(2,016,400)	928,500
Proceeds from maturities of held-to-maturity securities	5,907,815	7,825,249
Proceeds from sale of held-to-maturity securities	53,949	644,077
Purchases of held-to-maturity securities	(10,228,223)	(7,955,041)
Principal collected on advances	35,039,894	30,498,376
Advances made	(31,272,672)	(32,260,872)
Principal collected on mortgage loans held for portfolio	1,777,255	3,817,050
Purchases of mortgage loans held for portfolio	(1,402,435)	(5,954,841)
Net decrease (increase) in premises and equipment	(4,853)	(1,384)
Net cash provided by (used in) investing activities	$ (2,215,670)	$ (2,463,901)

Continued on the following page.

Statements of Cash Flows

CONTINUED

(Unaudited) (In thousands)	For the Nine Months Ended September 30, 2004	2003
Financing Activities		
Net increase (decrease) in deposits	$ (66,515)	$ 209,705
Net proceeds from issuance of consolidated obligations:		
Discount notes	176,408,628	131,407,875
Bonds	14,202,961	21,059,594
Payments for maturing and retiring consolidated obligations:		
Discount notes	(177,099,297)	(134,147,130)
Bonds	(11,321,713)	(16,312,862)
Proceeds from issuance of Class B(1) stock	81,936	80,125
Payments for redemption of Class B(1) stock	(126,385)	(84,027)
Payments for redemption of Class B(2) stock	(1,356)	(7,866)
Cash dividends paid	(66)	(66)
Net cash provided by (used in) financing activities	$ 2,078,193	$ 2,205,348
Net increase (decrease) in cash and cash equivalents	(799)	(10,113)
Cash and cash equivalents at beginning of the year	4,313	17,813
Cash and cash equivalents at end of the period	$ 3,514	$ 7,700
Supplemental Disclosures		
Interest paid	$ 1,048,668	$ 975,974
Stock dividends paid	64,268	94,231

See condensed notes to financial statements.

Condensed Notes to Financial Statements (Unaudited)

NOTE 1 – Summary of Significant Accounting Policies

Basis of Reporting

These unaudited financial statements and condensed notes should be read in conjunction with the financial statements and notes included in the 2003 Annual Report of the Federal Home Loan Bank of Seattle (Seattle Bank). These unaudited financial statements and condensed notes have been prepared in conformity with accounting principles generally accepted in the United States for interim financial information. Certain financial information, which is required in the annual financial statements, may not be required for interim financial reporting purposes and has been condensed or omitted.

In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of results for the interim periods have been included.

Accounting Adjustment

During the second quarter of 2004, we changed the manner of accounting we use to value and measure ineffectiveness for certain highly-effective hedging relationship transactions since our adoption of Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities,* on January 1, 2001. Under the prior approach, we assumed no ineffectiveness in these hedging transactions, while under the new approach we measure ineffectiveness at least quarterly. If this manner of accounting had been applied at the adoption of SFAS No. 133, the difference would not have been material to our results of operations or financial condition for any of these prior reporting periods. During the second quarter of 2004, we recorded an increase of $2.9 million to net income before assessments, reflecting the impact of the accounting change through March 31, 2004 as if we had employed the new approach from the date of adoption of SFAS No. 133 until our implementation of the new approach. The cumulative amount of these changes should offset each other if the derivative and hedged item are both held to maturity or their call dates, which is generally the case for these transactions. Nevertheless, we believe that these changes will lead to more volatility in our net income in future periods.

Use of Estimates

The preparation of financial statements requires management to make assumptions and estimates. These assumptions and estimates may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expense. Actual results could differ from these estimates.

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

Earnings Per Share

We calculate earnings per share by dividing net income by the average number of shares of Class B(1) and Class B(2) stock outstanding during the period. The computation of earnings per share is presented below.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
(In thousands, except per share data)				
Net Income	**$ 16,769**	$ 35,542	**$ 65,206**	$ 109,282
Average number of shares of Class B(1) and Class B(2) stock outstanding	**24,022**	24,397	**24,021**	23,910
Earnings per share	**$ 0.70**	$ 1.46	**$ 2.71**	$ 4.57

Reclassifications

Certain reclassifications have been made to the prior period amounts in Note 9, Segment Information, to conform to the current year presentation.

NOTE 2 – Recently Issued Accounting Standards and Interpretations

SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 149)

The Financial Accounting Standards Board (FASB) issued SFAS 149, which amends and clarifies financial accounting and reporting for derivative instruments and hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of Effective Date of FASB Statement No. 133*, and as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* (herein referred to as SFAS 133). In most cases, SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003, and, in most cases, all provisions of SFAS 149 should be applied prospectively.

Under SFAS 149, our mortgage loan purchase commitments entered into after June 30, 2003, are considered derivatives. The commitments are recorded as a derivative asset or derivative liability at fair value, with changes in fair value recognized in current-period earnings.

We adopted SFAS 149 as of June 30, 2003, and the adoption did not have a material impact on our financial statements.

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (SFAS 150)

SFAS 150 was issued in May 2003. As the Seattle Bank is a nonpublic entity with mandatorily redeemable financial instruments, the provisions of SFAS 150 are effective for us on January 1, 2005. We will adopt SFAS 150 as of the effective date. SFAS 150 requires an entity that issues equity shares to classify as a liability shares that meet certain redemption criteria. The redemption feature of our Class B(1) stock and Class B(2) stock meet the redemption criteria, therefore as of the effective date, we will reclassify the Class B(1) stock and Class B(2) stock from the capital section to the liability section of our statement of condition from the time a member submits a redemption request until we redeem the equity shares.

Because we generally process redemption requests when received, we do not expect the adoption of SFAS 150 to have a material impact on our financial statements.

NOTE 3 – Held-to-Maturity Securities

Major Security Types

Our held-to-maturity securities were as follows.

As of September 30, 2004 (in thousands)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
U.S. agency obligations	$ 5,056,962	$ 70,637	$ (25,350)	$ 5,102,249
Other Federal Home Loan Banks' bonds	8,025,368	18,478	(27,994)	8,015,852
State or local housing agency obligations	32,000	152	(113)	32,039
Other	264,171	15,498		279,669
	13,378,501	104,765	(53,457)	13,429,809
Mortgage-backed securities	7,266,804	56,736	(56,543)	7,266,997
Total	$ 20,645,305	$ 161,501	$ (110,000)	$ 20,696,806

As of December 31, 2003 (in thousands)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
U.S. agency obligations	$ 5,325,041	$ 117,911	$ (24,440)	$ 5,418,512
Other Federal Home Loan Banks' bonds	3,500,000	3,354	(2,044)	3,501,310
State or local housing agency obligations	41,273	225	(256)	41,242
Other	314,822	14,793		329,615
	9,181,136	136,283	(26,740)	9,290,679
Mortgage-backed securities	7,245,569	74,152	(48,061)	7,271,660
Total	$ 16,426,705	$ 210,435	$ (74,801)	$ 16,562,339

Condensed Notes to Financial Statements (Unaudited)

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The following table summarizes our held-to-maturity securities with unrealized losses as of September 30, 2004. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 months		More than 12 months		Total	
As of September 30, 2004	Estimated Fair Value	Gross Unrealized Loss	Estimated Fair Value	Gross Unrealized Loss	Estimated Fair Value	Gross Unrealized Loss
(in thousands)						
U.S. agency obligations	$ 2,063,058	$ (4,963)	$ 535,772	$ (20,387)	$ 2,598,830	$ (25,350)
Other Federal Home Loan Banks' bonds	4,117,449	(27,994)			4,117,449	(27,994)
State or local housing agency obligations	1,813	(2)	2,624	(111)	4,437	(113)
	6,182,320	(32,959)	538,396	(20,498)	6,720,716	(53,457)
Mortgage-backed securities	2,777,510	(33,833)	687,047	(22,710)	3,464,557	(56,543)
Total	$ 8,959,830	$ (66,792)	$ 1,225,443	$ (43,208)	$ 10,185,273	$ (110,000)

We have determined, based on the creditworthiness of the issuers and the value of underlying collateral, if any, and our ability and intent to hold the investment until recovery, that these unrealized losses in the above table represent temporary declines in value.

Redemption Terms

The amortized cost and estimated fair value of held-to-maturity securities, by contractual maturity, are shown below. Expected maturities of some held-to-maturity securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

	September 30, 2004		December 31, 2003	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(in thousands)				
Non-mortgage-backed securities				
Due in one year or less	$ 1,700,500	$ 1,706,644	$ 1,000,017	$ 1,005,075
Due after one year through five years	10,754,032	10,750,712	6,498,508	6,555,339
Due after five years through 10 years	804,345	852,114	1,541,594	1,588,358
Due after 10 years	119,624	120,339	141,017	141,907
Total non-mortgage-backed securities	13,378,501	13,429,809	9,181,136	9,290,679
Mortgage-backed securities				
Due after one year through five years			16,974	17,362
Due after five years through 10 years	108,236	112,368	65,972	70,066
Due after 10 years	7,158,568	7,154,629	7,162,623	7,184,232
Total mortgage-backed securities	7,266,804	7,266,997	7,245,569	7,271,660
Total	$ 20,645,305	$ 20,696,806	$ 16,426,705	$ 16,562,339

Condensed Notes to Financial Statements (Unaudited)

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The amortized cost of our mortgage-backed securities classified as held-to-maturity includes net discounts of $58.3 million and $64.5 million as of September 30, 2004, and December 31, 2003.

NOTE 4 – Securities Held at Fair Value

Major Security Types and Redemption Terms

Our securities held at fair value were as follows.

(in thousands)	September 30, 2004	December 31, 2003
U.S. agency obligations		
Due after 10 years	**$ 250,875**	$ 244,187
Total	**$ 250,875**	$ 244,187

Net gain and loss on securities held at fair value for the three months ended September 30, 2004 and 2003, included changes in unrealized gain of $14.4 million and loss of $12.8 million. For the nine months ended September 30, 2004 and 2003, net gain and loss on securities held at fair value includes changes in unrealized gain of $6.7 million and loss of $1.3 million.

NOTE 5 – Advances

Redemption Terms

As of September 30, 2004, and December 31, 2003, we had advances outstanding, including Affordable Housing Program (AHP) advances, at interest rates ranging from 1.14% to 8.62% and 1.03% to 8.65%, as summarized below. As of September 30, 2004, and December 31, 2003, AHP subsidized advance interest rates ranged from 2.80% to 5.99%.

	September 30, 2004		December 31, 2003	
Term to Maturity	Amount	Weighted Average Interest Rate %	Amount	Weighted Average Interest Rate %
(in thousands, except interest rate data)				
Due in one year or less	**$ 7,335,503**	**2.20**	$ 9,779,304	1.81
Due after one year through two years	**2,461,113**	**4.00**	3,087,950	2.81
Due after two years through three years	**1,296,172**	**3.63**	1,858,332	4.40
Due after three years through four years	**1,220,447**	**4.62**	913,428	3.71
Due after four years through five years	**745,313**	**4.22**	988,318	4.94
Thereafter	**2,575,572**	**5.14**	2,774,709	5.19
Total par value	**15,634,120**	**3.37**	19,402,041	2.95
Unamortized commitment fees	**(956)**		(1,027)	
Discount on AHP advances	**(433)**		(480)	
Deferred prepayment fees	**(2,231)**		(2,812)	
Derivative hedging adjustments	**189,114**		254,844	
Total	**$ 15,819,614**		$ 19,652,566	

Condensed Notes to Financial Statements (Unaudited)

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The following table summarizes the par value of advances as of September 30, 2004, and December 31, 2003, by term to maturity or next call date for callable advances. We have no callable advances outstanding as of September 30, 2004, and December 31, 2003.

Term to Maturity or Next Call Date	September 30, 2004	December 31, 2003
(in thousands)		
Due in one year or less	**$ 7,335,630**	$ 9,780,406
Due after one year through two years	**2,461,113**	3,088,083
Due after two years through three years	**1,296,172**	1,858,332
Due after three years through four years	**1,220,447**	913,428
Due after four years through five years	**745,313**	988,318
Thereafter	**2,575,445**	2,773,474
Total	**$ 15,634,120**	$ 19,402,041

Convertible advances are fixed-rate advances that provide us with the option to terminate the advance prior to maturity. In the event we terminate a convertible advance, we will provide alternative funding, at current advance rates, to the member for the remaining term of the terminated advance. As of September 30, 2004, and December 31, 2003, we had convertible advances outstanding of $3.2 billion and $3.6 billion.

The following table summarizes the par value of advances as of September 30, 2004, and December 31, 2003, by term to maturity or next put date.

Term to Maturity or Next Put Date	September 30, 2004	December 31, 2003
(in thousands)		
Due in one year or less	**$ 9,911,803**	$ 12,297,499
Due after one year through two years	**2,443,938**	3,140,242
Due after two years through three years	**1,221,660**	1,827,222
Due after three years through four years	**647,747**	716,215
Due after four years through five years	**522,314**	437,618
Thereafter	**886,658**	983,245
Total	**$ 15,634,120**	$ 19,402,041

Credit Risk

As of September 30, 2004, we had $82.2 million of advances to two borrowers classified as substandard. These advances are fully collateralized and because the borrowers continue to pay according to contractual requirements and because of our collateral position, interest continues to accrue on the advances.

We have never experienced a credit loss on an advance to a member. We have policies and procedures in place to appropriately manage our credit risk. Because of the collateral held as security on the advances and repayment history, we believe that an allowance for credit losses on advances is unnecessary.

Condensed Notes to Financial Statements (Unaudited)

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Interest-Rate Payment Terms

The following table details par value information on interest-rate payment terms for advances.

(in thousands)	September 30, 2004	December 31, 2003
Fixed-rate	**$ 10,692,871**	$ 12,287,277
Variable-rate	**4,941,249**	7,114,764
Total	**$ 15,634,120**	$ 19,402,041

NOTE 6 – Mortgage Loans Held For Portfolio

We purchase our mortgage loans held for portfolio from participating members through the Mortgage Purchase Program (MPP). The mortgage loans held for portfolio represent investments that our members originate, service, and provide any credit enhancement for. If the originiating member does not service a loan, the servicing for the loan is sold to a designated mortgage service provider at the time we purchase the loan.

The following table presents information on mortgage loans held for portfolio.

(in thousands)	September 30, 2004	December 31, 2003
Fixed, medium-term*, single-family mortgage loans	**$ 1,584,909**	$ 1,939,564
Fixed, long-term, single-family mortgage loans	**9,115,515**	9,141,616
Total par value	**10,700,424**	11,081,180
Unamortized premiums	**147,739**	158,034
Unamortized discounts	**(66,111)**	(67,697)
Total	**$ 10,782,052**	$ 11,171,517

** Medium-term is defined as a term of 15 years or less.*

The par value of mortgage loans held for portfolio outstanding as of September 30, 2004, and December 31, 2003, comprised government-insured loans totaling $2.4 billion and $2.5 billion and conventional loans totaling $8.3 billion and $8.6 billion.

Based on our analysis of our mortgage loans held for portfolio, we have determined that the credit enhancements provided by the sellers, including supplemental mortgage insurance, is sufficient to absorb inherent credit losses and that an allowance for credit loss is unnecessary. We had no nonaccrual loans as of September 30, 2004, and December 31, 2003.

Condensed Notes to Financial Statements (Unaudited)

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NOTE 7 – Consolidated Obligations

Consolidated Obligation Bond Redemption Terms

The following is a summary of our participation in consolidated obligation bonds outstanding as of September 30, 2004, and December 31, 2003.

	September 30, 2004		December 31, 2003	
Term to Maturity	Amount	Weighted Average Interest Rate %	Amount	Weighted Average Interest Rate %
(in thousands, except interest rate data)				
Due in one year or less	$ 9,394,295	2.49	$ 7,800,400	3.36
Due after one year through two years	8,362,300	3.07	7,840,595	2.75
Due after two years through three years	5,646,925	3.97	5,656,100	3.67
Due after three years through four years	4,845,050	3.86	3,902,625	4.81
Due after four years through five years	3,132,000	4.19	3,842,050	3.85
Thereafter	11,410,300	5.31	10,868,800	5.31
Total par value	42,790,870	3.83	39,910,570	4.00
Bond premiums	72,098		64,067	
Bond discounts	(91,155)		(75,777)	
Deferred net losses on terminated interest-rate exchange agreements	(84)		(101)	
Derivative hedging adjustments	(46,424)		10,515	
Total	$ 42,725,305		$ 39,909,274	

The following table summarizes the par value of our participation in consolidated obligation bonds outstanding as of September 30, 2004, and December 31, 2003, by call and put terms.

	September 30, 2004	December 31, 2003
(in thousands)		
Non-callable or non-putable	$ 25,154,320	$ 21,145,720
Callable	17,086,550	18,214,850
Putable	550,000	550,000
Total	$ 42,790,870	$ 39,910,570

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

The following table summarizes the par value of our participation in consolidated obligation bonds outstanding as of September 30, 2004, and December 31, 2003, by term to maturity or next call date.

Term to Maturity or Next Call Date	September 30, 2004	December 31, 2003
(in thousands)		
Due in one year or less	**$ 23,507,845**	$ 23,125,250
Due after one year through two years	**6,388,300**	5,880,295
Due after two years through three years	**3,604,925**	3,268,100
Due after three years through four years	**2,382,500**	2,527,625
Due after four years through five years	**1,405,000**	965,500
Thereafter	**5,502,300**	4,143,800
Total	**$ 42,790,870**	$ 39,910,570

Consolidated Obligation Discount Notes

Our participation in consolidated obligation discount notes, all of which are due within one year, was as follows.

	September 30, 2004	December 31, 2003
(in thousands, except interest rate data)		
Book value	**$ 5,915,797**	$ 6,609,074
Par value	**5,924,433**	6,613,749
Weighted-average interest rate	**1.68%**	1.06%

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

NOTE 8 – Capital

We are subject to three statutory capital requirements. As of September 30, 2004, and December 31, 2003, we were in compliance with these statutory capital requirements. These requirements are as follows:

First, we are required to hold risk-based capital equal to the sum of our credit-risk requirement, market-risk requirement, and operations-risk requirement, calculated in accordance with Federal Housing Finance Board (Finance Board) regulations. Only permanent capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. The Finance Board has the authority to require the Seattle Bank to maintain a greater amount of permanent capital than is required by the risk-based capital requirements, as defined, but has not done so.

(in thousands)	September 30, 2004	December 31, 2003
Permanent Capital		
Class B(1) stock	**$ 2,195,514**	$ 2,285,032
Class B(2) stock	**221,454**	113,473
Retained earnings	**58,049**	57,177
Permanent capital	**$ 2,475,017**	$ 2,455,682
Risk-Based Capital Requirement		
Credit-risk capital	**$ 220,538**	$ 172,940
Market-risk capital	**344,295**	361,599
Operations-risk capital	**169,450**	160,362
Risk-based capital requirement	**$ 734,283**	$ 694,901

Second, the Gramm-Leach-Bliley Act (GLB Act) imposes a 5% minimum leverage ratio based on total capital, which includes a 1.5 weighting factor applicable to permanent capital. A minimum leverage ratio, which is defined as total capital (with permanent capital multiplied by 1.5) divided by total assets, is intended to ensure that the Seattle Bank maintains a sufficient amount of capital to service our debt. The leverage ratio measures the degree to which we use debt. Leverage ratios at or near the 5% minimum would indicate that we have reached our maximum capacity to issue debt, and leverage ratios that exceed the 5% minimum indicate that we have additional capacity to fund operations through debt.

(in thousands, except ratio data)	September 30, 2004	December 31, 2003
Leverage Ratio		
Minimum leverage capital (5% of total assets)	**$ 2,660,388**	$ 2,558,191
Leverage capital (includes 1.5 weighting factor applicable to permanent capital)	**3,712,526**	3,683,523
Leverage ratio (leverage capital as a percentage of total assets)	**7.0%**	7.2%

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

Third, the GLB Act imposes a 4% minimum capital ratio, defined as total capital over total assets, that does not include the 1.5 weighting factor applicable to permanent capital. We use the capital ratio measure to monitor our operations. Capital ratios at or near the 4% minimum would indicate that we have fully utilized our capital resources to run our operations, and capital ratios that exceed the 4% minimum indicate that we have additional capacity to grow our asset base to increase earnings capacity.

(in thousands, except ratio data)	September 30, 2004	December 31, 2003
Capital Ratio		
Minimum capital (4% of total assets)	**$ 2,128,311**	$ 2,046,553
Capital ratio (permanent capital as a percentage of total assets)	**4.7%**	4.8%

Condensed Notes to Financial Statements (Unaudited)

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NOTE 9 – Segment Information

We have two operating segments, traditional member finance and the MPP. The products and services provided reflect the manner in which financial information is evaluated by management. The traditional member finance segment includes income primarily from the interest on advances and investments, less the borrowing costs related to those assets. The MPP segment includes income primarily from the interest on mortgage loans, less the borrowing cost related to those assets. We refined our method of allocating other expenses between the traditional member finance and MPP segments to better reflect the costs associated with each operating segment. The current and prior year amounts have been reclassified to conform to the new method of allocation.The following table presents our condensed statements of income by operating segment.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
(in thousands)				
Traditional Member Finance				
Net interest income	$ 30,659	$ 22,432	$ 80,980	$ 109,443
Other income (loss)	(3,979)	19,948	116	25,181
Other expense	(6,065)	(6,156)	(20,044)	(17,250)
Income before assessments	20,615	36,224	61,052	117,374
Assessments	(5,469)	(9,610)	(16,198)	(31,140)
Net income	$ 15,146	$ 26,614	$ 44,854	86,234
Mortgage Purchase Program				
Net interest income	$ 5,979	$ 17,789	$ 39,335	$ 41,803
Other income (loss)	275	(3,536)	1,041	(3,679)
Other expense	(4,045)	(2,100)	(12,675)	(6,752)
Income before assessments	2,209	12,153	27,701	31,372
Assessments	(586)	(3,224)	(7,349)	(8,324)
Net income	$ 1,623	$ 8,929	$ 20,352	$ 23,048
Total				
Net interest income	$ 36,638	$ 40,221	$120,315	$ 151,246
Other income (loss)	(3,704)	16,412	1,157	21,502
Other expense	(10,110)	(8,256)	(32,719)	(24,002)
Income before assessments	22,824	48,377	88,753	148,746
Assessments	(6,055)	(12,835)	(23,547)	(39,464)
Net income	$ 16,769	$ 35,542	$ 65,206	$ 109,282

The following table presents our total assets by operating segment.

	September 30, 2004	December 31, 2003
(in thousands)		
Traditional Member Finance	$ 41,164,019	$ 39,064,788
Mortgage Purchase Program	12,043,744	12,099,027
Total	$ 53,207,763	$ 51,163,815

Condensed Notes to Financial Statements (Unaudited)

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NOTE 10 – Estimated Fair Value

We have determined the following estimated fair value amounts of our financial assets and liabilities using available market information and our best judgment of appropriate valuation methods. We base these estimates on pertinent information available to us as of September 30, 2004, and December 31, 2003. Although we use our best judgment in estimating the fair value of these items, there are inherent limitations in any estimation technique or valuation methodology. For example, because an active secondary market does not exist for a portion of our financial instruments, in certain cases, fair values are not subject to precise quantification or verification and may change as economic and market factors and evaluation of those factors change. Therefore, these estimated fair values are not necessarily indicative of the amounts that would be realized in current market transactions.

The fair value summary tables do not represent an estimate of the overall market value of the Seattle Bank as a going concern, which would take into account, among other factors, future business opportunities. The carrying value and estimated fair values of our financial instruments were as follows.

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

As of September 30, 2004	Carrying Value	Net Unrealized Gain (Loss)	Estimated Fair Value
(in thousands)			
Assets			
Cash and due from banks	$ 3,514	$	$ 3,514
Interest-bearing deposits	940,000	(98)	939,902
Securities purchased under agreements to resell			
Federal funds sold	4,502,900	(614)	4,502,286
Investments:			
Held-to-maturity securities	20,645,305	51,501	20,696,806
Securities held at fair value	250,875		250,875
Advances	15,819,614	184,309	16,003,923
Mortgage loans held for portfolio	10,782,052	2,385	10,784,437
Accrued interest receivable	207,368		207,368
Derivative assets	32,332		32,332
Other assets	15,364		15,364
Liabilities			
Deposits	(1,250,223)	32	(1,250,191)
Consolidated obligations:			
Discount notes	(5,915,797)	1,664	(5,914,133)
Bonds	(42,725,305)	(542,732)	(43,268,037)
Accrued interest payable	(434,427)		(434,427)
Derivative liabilities	(292,577)		(292,577)
Other liabilities	(65,079)		(65,079)
Other			
Commitments to extend credit for advances	956		956
Commitments to extend credit for mortgage loans held for portfolio	(34)		(34)
Commitments to issue consolidated obligation bonds		6,096	6,096
Commitments to enter into interest-rate exchange agreements		530	530

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

As of December 31, 2003	Carrying Value	Net Unrealized Gain (Loss)	Estimated Fair Value
(in thousands)			
Assets			
Cash and due from banks	$ 4,313	$	$ 4,313
Interest-bearing deposits	770,000	22	770,022
Securities purchased under agreements to resell	100,000		100,000
Federal funds sold	2,506,500	15	2,506,515
Investments:			
Held-to-maturity securities	16,426,705	135,634	16,562,339
Securities held at fair value	244,187		244,187
Advances	19,652,566	219,282	19,871,848
Mortgage loans held for portfolio	11,171,517	(15,470)	11,156,047
Accrued interest receivable	222,045		222,045
Derivative assets	45,766		45,766
Other assets	14,957		14,957
Liabilities			
Deposits	(1,316,738)	(4)	(1,316,742)
Consolidated obligations:			
Discount notes	(6,609,074)	151	(6,608,923)
Bonds	(39,909,274)	(668,090)	(40,577,364)
Accrued interest payable	(374,298)		(374,298)
Derivative liabilities	(306,513)		(306,513)
Other liabilities	(134,878)		(134,878)
Other			
Commitments to extend credit for advances	1,027		1,027
Commitments to extend credit for mortgage loans held for portfolio	(2,736)		(2,736)
Commitments to issue consolidated obligation bonds		2,644	2,644
Commitments to enter into interest-rate exchange agreements		(232)	(232)

Condensed Notes to Financial Statements (Unaudited)

CONTINUED

NOTE 11 – Subsequent Event

Subsequent to September 30, 2004, we repurchased $107.7 million of Class B(1) stock and $229.5 million of Class B(2) stock. Member institutions can elect to redeem their stock with five years' notice. We can repurchase stock prior to the expiration of the five-year notice period, at our discretion, as long as we are in compliance with Finance Board minimum capital level requirements. Member institutions are required to hold Class B(1) stock to meet membership and activity stock purchase requirements. Member institutions are not required to hold any Class B(2) stock.

We reviewed our capital requirements and determined that granting the redemption requests for Class B(1) stock and Class B(2) stock in these amounts would not affect our compliance with Finance Board minimum capital level requirements. Based on this determination, the Class B(1) stock and Class B(2) stock redemption requests were processed and the capital was returned to the member institutions in October 2004.